What's News in Tax

Analysis that matters from Washington National Tax

In Case You Missed It: "Other" Provisions of the TCJA

April 1, 2019

by James Atkinson, Catherine Fitzpatrick, and Terri Stecher, Washington National Tax[*]

Taxpayers should be aware of important—but sometimes overshadowed—domestic provisions changed by tax reform. Although by no means exhaustive, this article provides a snapshot discussion of some key changes in the areas of tax accounting and compensation and benefits.

The 2017 tax reform legislation commonly referred to as the Tax Cuts and Jobs Act ("TCJA") included a number of "headliner" provisions. These include GILTI, BEAT, FDII, and mandatory repatriation in the international area, as well as 100 percent bonus depreciation, limitations on interest deductibility and the usage of NOLs, changes to the recognition of income, and section 199A[1] on the domestic side. More than a few barrels of ink understandably have been expended in discussions, comment letters, and even IRS guidance regarding these provisions.

Standing outside that spotlight, however, are quite a few less glamorous provisions of which taxpayers should at least be aware. Although these provisions do not have the sweeping breadth of their more illustrious brethren, they can be equally important for those taxpayers to whom they do apply. The following discussion attempts only to identify some of the "other" provisions in the income tax and accounting and employee compensation and benefits areas, of which taxpayers and their advisors

---

[*] *James Atkinson is a principal in the Income Tax and Accounting group of Washington National Tax ("WNT") and a former IRS Associate Chief Counsel (Income Tax and Accounting). Catherine Fitzpatrick is a partner in the WNT Income Tax and Accounting group. Terri Stecher is a director in the WNT Compensation and Benefits group.*

[1] Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

should be aware. The discussion leaves a deeper dive into these areas to other sources. (An expanded discussion for many of these topics can be found in *Tax Reform – KPMG Report on New Tax Law* (or the tax reform resource page).)

Expanded Taxation of Government Grants

The TCJA effectively repealed section 118 as applied to non-shareholder contributions to capital. As a consequence, nearly all cash grants received either from a governmental entity or from a civic organization will now be included in taxable income. The ability to exclude cash-based location incentives, for example, by applying the so-called "*CB&Q* factors" no longer applies, effective for contributions made after December 22, 2017 (the TCJA enactment date).

Contributions made pursuant to a "master development agreement" approved by the governmental entity prior to December 22, 2017, however, are grandfathered in and may still be excluded under the pre-TCJA version of section 118 (assuming the payment satisfies all the requirements of prior law). Pending additional guidance from the government, the meaning of this term remains open to interpretation.

Importantly, the repeal of section 118 for non-shareholder contributions to capital has no effect upon location incentives structured as tax abatements. The legislative history to the TCJA states explicitly that tax abatements are not taxable. The IRS concurs. Other planning structures also may be available to ensure more favorable tax treatment without unduly changing the economics of the deal.

Finally, on certain facts, a common law "inducement theory" also may be available. As a caveat, the IRS is unlikely to allow this theory to fully substitute for the now repealed provisions of section 118.

For additional discussion on this topic, please see James Atkinson and John Geracimos, "2017 Tax Reform's Limitation of Favorable Non-Shareholder Contribution to Capital Treatment: Contribution to Uncertainty," Bloomberg Tax-*Tax Management Memorandum* (Feb. 2018).

Restrictions on Like-Kind Exchanges

The TCJA significantly contracted the scope of section 1031, governing the treatment of like-kind exchanges. As amended, section 1031 now applies only to qualifying exchanges of real property. As a consequence, taxpayers may no longer defer recognizing gain realized upon the exchange of any items of personal property or of intangible property. This change will have a profound effect upon companies routinely engaging in like-kind exchanges of vehicles and heavy equipment, as well as those engaging in exchanges of intangible property, including broadcast licenses or spectrum, license or lease agreements, or even professional sports contracts (i.e., "trading players").

Affected companies and teams now may have to wrestle with significant valuation issues not previously considered, particularly as it relates to intangible assets such as player contracts.

For additional discussion on this topic, please see Holly Belanger, Monica Swanson, and Tom Wilson, "To Trade or Not to Trade: How Much Is that Player Contract Worth?" *What's News in Tax* (June 18, 2018).

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Specified Liability Losses

The TCJA changes in how taxpayers account for net operating losses has attracted a significant amount of discussion. In general, the TCJA permits taxpayers to apply NOLs only to a stated percentage of their income, disallows NOL carrybacks, and permits indefinite NOL carryforwards. The details obviously are more complex, but that is the gist.

Sometimes lost in this big-picture discussion, however, is the repeal of section 172(f), applicable to "specified liability losses," as part of this restructuring of the NOL rules. Under prior law, section 172(f) provided an extended carryback period—10 years in most cases—for losses attributable to certain types of expenditures. In general, the special rule was targeted to high-dollar, long time-horizon obligations, such as nuclear decommissioning, the dismantlement of offshore drilling platforms, environmental cleanup, and certain workers compensation payments. It also applied broadly to product liability costs. While the specified liability loss rules may not have applied to a wide cross-section of taxpayers, for those to whom it did apply, the immediate cash flow benefits arising from "quickie refunds" made possible by the provision could be substantial.

As currently drafted, the new NOL limitations (and thus the repeal of section 172(f)) apply to losses arising in tax years beginning after December 31, 2017. The provision allowing indefinite carryovers and modifying carrybacks applies to losses arising in tax years ending after December 31, 2017.

As a result, qualifying expenditures incurred in loss years beginning before January 1, 2018, currently remain eligible for the 10-year carryback permitted under prior law. Because this treatment is not an accounting method, eligible taxpayers remain entitled to identify and claim qualifying specified liability losses and to request a refund of any resulting overpayment in prior tax years.

Limitation on Deductions for Payments Related to Sexual Harassment and Sexual Abuse

The TCJA added new section 162(q) to the Code. This provision denies a tax deduction for settlements or payments related to sexual harassment or sexual abuse if the payments are subject to a nondisclosure agreement. Attorney's fees associated with such a settlement or payment likewise are no longer deductible. Attorney's fees incurred by the recipient of the payment or the beneficiary of the settlement are not subject to the new rule.

This provision is about more than timing—it permanently disallows a deduction for any payment described in section 162(q).

The disallowance is effective for amounts paid or incurred after December 22, 2017 (the TCJA date of enactment). Unlike other provisions enacted in the TCJA, neither the provision nor its legislative history grandfather agreements executed prior to that date. Instead, the disallowance is based on the payment date for both cash and accrual method taxpayers.

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Limitation on Deductions for Certain Fines and Penalties

The TCJA further narrows section 162 by denying a deduction for any payment to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or an investigation into the potential violation of law.

A key exception to this rule applies if (1) the payment is for restitution (including remediation of property) or is required for the taxpayer to come into compliance with the law, and (2) the payment is identified as such in the underlying court order or settlement agreement.

Importantly, restitution does not include reimbursement of investigatory or litigation costs incurred by the government, making those costs nondeductible.

In considering this restriction, taxpayers should keep in mind that it applies only to payments made in relation to the "violation of any law" or the government's investigation of a potential violation of law. Not all payments made to or at the direction of the government necessarily fall within this new restriction.

Being aware of and complying with the new documentation requirements (i.e., specific descriptions in the court order or settlement agreement) is critical for taxpayers making otherwise deductible payments now falling within the scope of this new prohibition. Failing to do so could result in the permanent loss of an otherwise permissible deduction, which in many cases can be substantial.

The new restriction is effective for amounts paid or incurred after December 21, 2017. The TCJA makes an exception for amounts paid or incurred under a binding order or agreement entered into prior to that date (provided any required court approval is obtained prior to that date).

Small Business Provisions

Under prior law, varying gross receipts thresholds applied to exempt certain taxpayers from having to apply accrual method principles. Specifically:

- A business organized as a C corporation, or a partnership with a C corporation partner, could use the cash method of accounting, if for each prior tax year its average annual gross receipts did not exceed $5 million ($1 million for farm corporations and farm partnerships).

- Under IRS guidance, businesses were not required to use the accrual method of accounting and account for inventories if their gross receipts did not exceed $1 million (under subsequent IRS guidance, the threshold was increased to $10 million for businesses in certain industries).

- The UNICAP rules exempted a reseller from the requirements to apply section 263A (detailed inventory accounting rules) if the reseller's average annual gross receipts for the prior three tax years was $10 million or less.

- Taxpayers that entered into long-term construction contracts were permitted to use the completed contract method of accounting if average annual gross receipts were less than $10 million for the prior three years.

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

The TCJA increased the gross receipts thresholds described above to $25 million—each threshold is applied annually and is determined by averaging the gross receipts for the prior three years. As a result, the population of businesses that is allowed to apply cash method principles, with respect to both their overall accounting method and in accounting for inventories, has expanded. This may be especially helpful for taxpayers that would have been required under an accrual method (pursuant to section 451, as revised by the TCJA) to accelerate recognition of revenue due to the new "book conformity" provision, but will now be eligible to use the cash method.

Any change under these provisions is generally treated as a change in accounting method with a cumulative catch up adjustment (section 481(a) adjustment), except changes for long-term construction contracts, which are made prospectively. The IRS issued Revenue Procedure 2018-40, which generally permits an eligible small business taxpayer to make these changes under the automatic method change procedures.

Self-Created Property

The TCJA revised section 1221 to provide that gain or loss arising from the sale, exchange, or other disposition occurring after December 31, 2017, of a self-created patent, invention, model or design, secret formula or process, is no longer treated as gain or loss from the sale of a capital asset. Gain or loss on the disposition of other self-created intangibles, such as personal goodwill, client lists, customer contracts, etc., are still eligible for capital gain treatment. As a result of the law change, valuations may become more important in the context of a sale of a business containing multiple identifiable intangibles.

Employee Benefit Provisions

Employer-Provided Parking

The TCJA disallows deductions for expenses paid or incurred after December 31, 2017, for providing qualified transportation fringe ("QTF") benefits to employees, including parking, under new section 274(a)(4). QTF benefits remain excludible from employee income up to an annual indexed limit ($260/month in 2018 and $265/month in 2019).

Section 274(a) now expressly disallows deductions for "the expense of any qualified transportation fringe (as defined in section 132(f)) provided to the employee of the taxpayer." Qualified parking is considered a QTF and includes parking on or near the employer's business premises or at a location from which the employee commutes to work (mass transit, carpool, etc.). Employers that own or lease parking lots will now need to perform an analysis to identify expenses associated with providing parking to their employees, regardless of whether or not employees pay for parking or whether there is a value associated with the parking.

Notice 2018-99 includes some guidance on employer-provided parking. The notice specifies that parking expenses are viewed broadly and may include, but are not limited to, lease or rental expenses, maintenance, snow and leaf removal, security, and landscaping. However, depreciation is not included

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

as a parking expense. Notice 2018-99 provides a four-step method for determining the allocation of nondeductible expenses. Reserved employee parking spaces are nondeductible. However, parking lots with the primary use (greater than 50 percent) for public parking may be fully deductible if there are no reserved employee parking spots. The notice also provides a transition rule for employers to reduce or eliminate their reserved employee parking spots through March 31, 2019, and treat this change as retroactive to January 1, 2018.

Commuting Expenses

Commuting expenses paid or reimbursed by an employer for an employee are no longer deductible after December 31, 2017. The TCJA added section 274(l), which provides that transportation provided or expenses paid or reimbursed for commuting to work are no longer deductible.

There are exceptions to several section 274 deduction limitations if the expense is included in employee compensation. The commuting expense provision, however, currently does not have an exception allowing a deduction if amounts are included in employee compensation. Exceptions to the commuting expense rule include (1) bicycle commuting reimbursements, which are included in employee compensation for tax years beginning after December 31, 2017, and before January 1, 2026; and (2) commuting expenses necessary for ensuring the safety of employees. Items such as van pool expenses or taxi rides to work would fall under section 274(l). Commuting expenses on a corporate aircraft are also subject to the section 274(l) deduction disallowance.

Entertainment

Under the TCJA, entertainment expenses are generally nondeductible, except for a few exceptions such as amounts included in employee compensation. Prior to the TCJA, entertainment expenses that were directly related to the conduct of a trade or business were partially deductible. Under the new rules, entertainment expenses even if directly related to business are generally nondeductible. However, the IRS in Notice 2018-76 clarified that business meals comingled with entertainment remain 50 percent deductible if the meals are separately purchased or separately stated on an invoice from the entertainment expenses.

Meals

The TCJA has limited the deduction for certain food and beverages that had previously been fully deductible. De minimis food and beverages, such coffee and snacks in an office pantry, are now subject to a 50 percent deduction limit. These de minimis snacks and beverages are still excludable from employee compensation, but the employer expense is no longer fully deductible. In addition, meals in an employer-provided dining room that meet the de minimis exception or are for the convenience of the employer are now subject to a 50 percent deduction limit. The TCJA did not change the deduction of business meals, which had already been subject to a 50 percent deduction limit.

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

Section 162(m) Deduction Limitation

Section 162(m) limits the corporate deduction for covered employee compensation to $1 million. The TCJA significantly expanded the section 162(m) provisions:

- Expanding the definition of covered employee,
- Repealing the exception for performance-based compensation and commissions, and
- Expanding the coverage of section 162(m) to all domestic publicly traded corporations and all foreign companies publicly traded through ADRs.

The definition of "covered employee" has been expanded under the TCJA and now (1) includes the CFO; (2) eliminated the "last day of the tax year" language; and (3) any individual who is a covered employee for a tax year beginning after December 31, 2016, will always be considered a covered employee (including upon retirement and death).

A transition period provides that section 162(m) expansion will not apply to compensation under a written, binding contract in effect on November 2, 2017, that was not materially modified. Notice 2018-68 provides some limited guidance on the application of the transition period. For an agreement to be grandfathered, the notice provides that the arrangement as well as the amount must be legally binding under applicable state law.

□□□□

The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.

© 2019 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.