SYMPOSIUM OUTLINE

REGULATIONS UPDATE: 301 DIVIDENDS/REDEMTIONS

301 UPDATES:

On the 26 of March 2019, the Treasury / IRS proposed updating section 301 of the Regulation to mirror the statutory amendments brought by way of the Technical and Miscellaneous Revenue Act of 1988.[1]

The scope of the amendments produced by these Proposes Regulations is restricted to: "(1) deleting regulatory provisions made obsolete by statutory changes, (2) making minor additions and revisions to regulatory provisions to reflect current statutory text, and (3) making certain non-substantive changes for purposes of clarity and readability, including reordering and re-designating paragraphs of the current regulations."[2]

Before 1986, the amendments to section 301(b)(1) imposed on taxpayers special rules to determine the basis of property from foreign distributing corporations, and corporate distributees.[3] Prior to the amendment, Section 301 of the Code provided generally that, in the case of a corporate distribution of property to a corporate distributee, "the amount distributed equaled the lesser of (1) the fair market value of the property or (2) the adjusted basis of the property in the hands of the distributee, increased in the amount of gain recognized to the distributing corporation on the distribution."[4] Or in other words, the basis of the property in the hands of the distribute is the same as the amount distributed under Section 301(d).

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[1] *See* UPDATING SECTION 301 REGULATIONS TO REFLECT STATUTORY CHANGES, 84 FED. REG. 11263 (proposed Mar. 26, 2019) (to be codified at 26 C.F.R. pt. 1).
[2] *Id*. at 11264.
[3] *Id.*
[4] *See* THE TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988, PUB. L. NO. 100-647, § 1006(E), 102 STAT. 3342 (1988) (Enacted H.R. 4333, 100 Enacted H.R. 4333).

The Technical and Miscellaneous Revenue Act of 1988 amended §301(b)(1) to eradicate the differences between corporate and non-corporate distributees and special rules relating to foreign corporations. Additionally, section 1019(a) of the act provides that these 1998 amendments "were effective, as if included in the Tax Reform Act of 1986."[5] As a consequence of these amendments, Section 301(b) now holds that the amount of any distribution shall be the amount of money received plus the fair market value of other property received. Additionally, Section 301 (d) holds "that the basis of property received in a distribution to which sections 301(a) applies shall be the fair market value of the property.[6]

Prop. Reg. Section 1.302-1(e) Example:

> Corporation M, formed in 1998, has never been an acquiring corporation in a transaction to which section 381(a) applies. On January 1, 2019, A, an individual owned all of the stock of Corporation M, consisting of a single share, with an adjusted basis of $2,000. During 2019, A received distributions from Corporation M totaling $30,000, consisting of $10,000 in cash and listed securities having a basis in the hands of Corporation M and $20,000 of fair market value on the date distributed. Corporation M's taxable year is the calendar year. As of December 31, 2018, Corporation M had accumulated earnings and profits in the amount of $26,000, and it had no earnings and profits and no deficit for 2019 ,[section 316(a) (1); & section 301(c) (1)]. Of the $30,000 received by A, $26,000 will be treated as an ordinary dividend; [section 301(c)(1)] the remaining $4,000 will be applied against and reduce the adjusted basis of his stock; [section 301(c) (2)] the $2,000 in excess of the adjusted basis of his stock will be treated as gain from the sale or exchange of property under [section 301(c)(3)(A)], reducing A's stock basis to zero. If A subsequently sells his stock in Corporation M, the basis for determining gain or loss on the sale will be zero.[7]

Ultimately, the proposed regulations have modernized Section 1.301-1 and reflect the statutory changes that were already implemented by the 1988 Amendments.

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[5] *See* UPDATING SECTION 301 REGULATIONS TO REFLECT STATUTORY CHANGES, 84 FED. REG. at 11264.
[6] *Id*.
[7] *Id*. at 11266.

Specifically, to sections 301(b)(1) and (d).[8] Furthermore, certain provision of the current Section 1.301-1(b) can be now found in proposed regulation Sections 1.301-1(c). Accordingly, the definition of the amount of a distribution subjected to section 301 and the determination of fair market value of a distribution can be found in 1.301-1(b). However, the determinations of when to include a distribution in gross income, and its fair market value, can now be found in proposed regulation 1.301-1(c).[9] Perhaps this is for purpose of "clarity and readability". Moreover, current sections 1.301-1(g) has now been reassigned to proposed regulation Section 1.301-1(f). It has been revised in order to demonstrate the application of the principles of Section 357(d) regarding the limitation on the amount of distributions provided by Sections 301(b)(2).[10] The proposed regulation provides that there will be no reduction to property distributed with liabilities unless the distribute/shareholder assumes the liability and in no event below zero. On March 28, 2019 the Treasury withdrew the 2009 Proposed Regulations regarding the allocations and recovery of stock basis in redemptions, having determined "it is unlikely that the approach of the 2009 Proposed regulations can be implemented in comprehensive final regulations without significant modifications."[11] In other words, a dividend-equivalent redemption results in a pro rate share-by share distribution to all shares of the redeemed class held by redeemed shareholder.[12]

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[8] *Id*. at 12264.
[9] *Id*.
[10] *Id*.
[11] *See* THE ALLOCATION OF CONSIDERATION AND ALLOCATION AND RECOVERY OF BASIS IN TRANSACTIONS INVOLVING CORPORATE STOCK OR SECURITIES; WITHDRAWAL, 84 FED. REG. 11263 (Proposed Jan. 21, 2009) (to be codified at 26 C.F.R. pt. 1) (Withdrawn Mar. 28, 2019).
[12] *See* Johnson v. United States, 435 F.2d 1257 (4th Cir. 1971); *see also* Ill. Tool Works, Inc. v. Commissioner, No. 10418-14, 2018 Tax Ct. Memo LEXIS 122 (T.C. Aug. 6, 2018).

Lastly, Treasury holds that with regard to redemptions under section 302(d) that are treated as dividends, any unrecovered basis in the redeemed stock of a shareholder may be shifted to other stock only if such an adjustment is proper adjustment within the meaning of Treas. Reg § 1.302-2(c) .[13] In Notice 2001-45, IRS took the position that a basis shift from a non-US taxpayer to US taxpayer was "not a proper adjustment" within the meaning of Reg. Section 1.302-2(2)(c). Notwithstanding the foregoing, one of the more controversial provisions in the 2009 Proposed regulations is Prop. Regulation Section 1.302-5(b)(4) that prohibits the shift of unrecovered stock basis in redeemed stock to other stock not redeemed and held by the distribute/shareholder or if not remaining stock held to the stock attributed to the redeemed shareholder under section 318, "deferring" the basis recovery until the an "inclusion date" in the future. This magical "inclusion date" is when the facts and circumstances occur that would treat the distribution as a redemption, if they had occurred at the time of the original date of the purported redemption.[14]

CONTINUITY OF INTEREST (COI)

BACKGROUND:

The IRS has announced that proposed regulation (REG-124627-11) will be withdrawn. The proposed regulation were originally published on December 19, 2011 and aimed to aid taxpayers in understanding how certain transactions, such as a reorganizations, could meet the criteria of Continuity of Interest (COI) under Reg. Section 1.368-1(e).[15] Specifically, the proposed regulation afforded taxpayers with a procedure for determining if the COI requirement is met when a potential reorganization is significantly affected by the altering price of the issuing corporation

[13] *Id*.
[14] *See* NOTICE 2001-45, 2001-33 I.R.B. 129.
[15] *See* CORPORATE REORGANIZATIONS; GUIDANCE ON THE MEASUREMENT OF CONTINUITY OF INTEREST, 84 FED. REG. 12169 (April 01, 2019).

stock. Accordingly, the proposed regulation allowed for an average of trading prices, over several of days, of the issuing corporation stock be used rather than the corporation's stock actual trading price on the closing date.[16]

Originally, the COI requirement served to stop corporate reorganizations, that were disguised as sales, from taking advantage of a nonrecognition treatment. Accordingly, the COI requirement was satisfied only if a substantial amount of the value of the target corporation was preserved in the reorganization.[17] Moreover, in order to determine if the COI requirement was in fact met, "the value of the issuing corporation's stock that the target corporation's shareholders receive is compared to the aggregate value of the consideration the target shareholders received." [18] Traditionally, under Reg. section 1.368-1 (e) (2) (v), Ex. 1, the IRS has recognized reorganizations to meet the COI requirement when at least 40% of the consideration received by target corporations shareholders' consist of stock of the issuing corporation.[19] Furthermore, prior to the proposed regulations, the value of the issuing corporations stock was determine at the Closing Date,

Example: Under Treas. Reg. Sec. 1.368-1(e)(2)(v) the IRS illustrates the following scenario where the continuity of interest requirement is met:

> On January 3 of year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Twenty of the P shares, however, will be placed in escrow to secure customary target representations and warranties. The P stock is listed on

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[16] *See IRS withdraws proposed regulations on determining continuity of interest for variable consideration contracts*, EY (Mar. 29, 2019), https://taxnews.ey.com/news/2019-0649-irs-withdraws-proposed-regulations-on-determining-continuity-of-interest-for-variable-consideration-contracts.

[17] *See Treasury withdraws continuity of interest Proposed Regulation,* PWC (Apr. 8, 2019), https://www.pwc.com/us/en/tax-accounting-services/newsletters/global-information-reporting-withholding/assets/pwc-treasury-withdraws-continuity-of-interest-proposed-regulations.pdf

[18] *See* TREAS. REG. SEC. 1.368-1(e)(1)(i)

[19] *See Treasury, supra* note 17.

> an established market. On January 2 of year 1, the value of the P stock is $1 per share. On June 1 of year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is $.25 per share. None of the stock placed in escrow is returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph 1.368-1(e)(2), there is a binding contract providing for fixed consideration as of January 3 of year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on the pre-signing date. Because, for continuity of interest purposes, the T stock is exchanged for $40 of P stock and $60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Thus, the transaction satisfies the continuity of interest requirement.[20]

ENACTMENT OF REV. PROC. 2018-12 AND THE 3 SAFE HARBORS

Rev. Proc. 2018-12 was officially issued on January 2018. The Revenue Procedure expanded from Reg-123627-11 and provided taxpayers with 3 different methods for assessing the value of target corporations stock in order to determine if the COI requirement was met. Furthermore, the IRS has expressed that it will not challenge the valuation of the corporation stock as long as the safe harbor requirements of Rev. Proc. 2018-12 have been met.[21]

As mentioned earlier, there are 3 safe harbors that rev. Proc. 2018-12 created. Accordingly, the 3 safe harbors are as follow:

> (1) Average of the Daily Volume Weighted Average Prices. For each class of Exchange Traded Stock, taxpayers may use the average of the daily volume weighted average prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period (see section 4.02 of this revenue procedure). (2) Average of the Average High-Low Daily Prices. For each class of Exchange Traded Stock, taxpayers may use the average of the daily average high-low trading prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period. And lastly, (3) Average of the Daily Closing Prices. For each class of Exchange Traded Stock, taxpayers may use the average of the daily closing

[20] *See* TREAS. REG. SEC. 1.368-1(e)(2)(v), Ex. 1.
[21] *See Treasury, supra* note 17.

prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period. [22]

However, all 3 of the Safe Harbor's valuations must be made within the requisite measuring period. Accordingly, Rev. Proc. 2018-12 states that the measuring period must be between 5 to 35 consecutive trading days. Additionally, the trading period must not exceed the closing date, if the closing date is a trading day. Furthermore, it must end no later than the last trading day before the closing date.[23]

The creation of Rev. Proc. 2018-12 presented a more detailed guidance than the 2011 proposed regulation. This subsequently led Treasury to recognize that the guidance provided by the 2011 proposed regulation was no longer needed. Ultimately, leading Treasury to withdraw of the proposed regulations. However, by conserving the Safe Harbors of Rev. Proc. 2018-12 the IRS is supporting the use of average trading price, rather than estimating the value of the issuing corporation stock solely on its Closing Date price.[24]

SECTION 355 UPDATE: PILOT PROGRAM

BACKGROUND

Under Rev. Proc. 2017-52, the IRS created a pilot program indented to issue rulings regarding tax consequences under Section 355. The pilot program was originally designed to run until March 19, 2019. However, treasury and the IRS announced on March 12, 2019 that the program will continue to run indefinitely.[25]

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[22] *See* REV. PROC. 2018-12.
[23] *Id*. at 9.
[24] *See Treasury, supra* note 17.
[25] *See IRS Statement on Private Letter Ruling Pilot Program Extension*, IRS (Mar. 12, 2019), https://www.irs.gov/newsroom/irs-statement-on-private-letter-ruling-pilot-program-extension.

Generally, distributions from corporations to shareholders of property that have appreciated in value are normally taxed at the corporate and shareholder level. However, Section 355 provides for a specific exception to this general rule. In order to fall within the scope of the Section 355 exception, a transaction must meet both statutory and judicially created requirements. "It must be for a valid business purpose, must meet a continuity of shareholder interest and continuity of at least one active trades or businesses that have been conducted for at least five previous years, and that were not acquired in a taxable manner during those five years." [26]

The requirements, at face value, may seem simple, however, they are highly complex and require deep analysis that includes research of the makeup and history of the corporations that intend on making the stock distribution.[27] Moreover, an entire transaction may be disqualified if there is a subsequent acquisition of the distributing or controlled corporation. This complex, and costly issue has often forced taxpayers to rely on requests to the IRS in the form of Revenue Rulings to ensure that their transactions qualify as tax-free under sections 355.[28]

Prior to Rev Rul. 2017-52, the IRS had issued numerous rulings on the tax consequences of Section 355 distributions. This included the issue of whether the distribution was primarily a device for the distribution of E&P, the valid corporate business purpose requirement and Section 355(e) issues. However, in rev Proc 2003-48 the IRS announced that it would no longer rule in certain aspects of Section 355 distributions, including the issue of whether the distribution was primarily a device for the distribution of E&P, the valid corporate business purpose requirement, and section 355(e) issues. Moreover, in Rev Proc. 2013-32, the IRS announced even further restrictions stating that they would no longer rule on Section 355 distributions transactions except,

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[26] *See IRS to Keep Ruling on Section 355 Transactions After Pilot Program Ends*, BDO (Feb. 2019), https://www.bdo.com/insights/tax/federal-tax/irs-to-keep-ruling-on-section-355-transactions-aft.
[27] Id.

on "significant issues" i.e. specific issues of law. Thereafter, in Rev. Proc. 2016-45 the IRS announced that significant issue rulings would be issued on the device prohibition, and corporate business purpose requirement, which were previously "no rule" areas under Rev. Proc. 2003-48.[29]

Ultimately, the extension is good news for taxpayers. The program will continue to provide taxpayers with guidance on determining the complex, and often confusing, tax consequences of distributions under Sections 335.[30]

REVENUE RULING 2019-09: ACTIVE TRADE OR BUSINESS REQUIRMENT (ATB)

One of key requirement under Section 355 is the Active Trade or Business Requirement (ATB). Under Section 355(b) it states that a corporation must be engaged in an active trade or business. Sections 355(b) regulations have traditionally found that an active trade or business includes the collection of income and the payment of expenses. [31]

However, there has been a substantial increase in entrepreneurial ventures. Generally, these ventures have phases that consist of performing research and development. During these phases the ventures collect no income. But they are engaged in activity that has often been recognized as evidence of an active trade or business, such as financial expenditures and day-to-day operational and managerial task. This increase in entrepreneurial ventures has led Treasury and the IRS to consider if entrepreneurial activities can be sufficient to meet the active trade or business

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[29] *See IRS extends pilot program for requesting letter rulings on certain corporate stock distribution*, PWC (Mar. 15, 2019), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-pilot-prog-extended-to-req-plr-for-some-corp-stock-distributions.pdf.
[30] *Id*.
[31] *See* 26 U.S. CODE §355; see also *IRS considering "active trade or business" guidance research activities*, KPMG (Sep. 25, 2018), https://home.kpmg/xx/en/home/insights/2018/09/tnf-irs-considering-active-trade-or-business-guidance-for-ventures-with-research-activities.html.

requirement. Specifically, when the activities are done with a purpose to earn income in the future, but none has been collected yet. [32]

In order to come to a conclusion, the IRS is requesting information that may aid them in identifying what types of entrepreneurial ventures should qualify under the active trade of business requirement. The IRS has particularly asked:

> In what industries or industry segments do the types of R&D ventures described above, as well as in the September 2018 IRS statement, exist?
> How are these ventures created?
> If no income is collected for extended periods, how are these ventures funded?
> In what circumstances do these ventures typically receive grants or similar funding?
> What types of organizations make these grants and on what terms?
> Is it common for investments in, or grants to, these ventures to include rights to acquire interests in potential products of the research, rights to use such products, or similar rights?
> What types of managerial and operational activities of these ventures generally are conducted by employees?
> What types of activities generally are conducted by independent contractors or their employees?
> What proportion of these ventures' managerial and operational activities is conducted by employees, as compared to independent contractors (for example, based on personnel number, hours spent, or amounts of expenditures)?
> What steps are necessary to obtain regulatory approval of products developed in the R&D phase of these ventures, and how do these steps vary by industry?
> Is it possible to generalize about the amounts of time necessary to accomplish these regulatory approval steps?
> Is it possible to generalize about the nature of activities and the levels of activity required to accomplish these regulatory approval steps (for example, based on numbers of hours spent by managerial and operational employees, asset values, or expenditure amounts)?
> What types of opportunities exist to collect income from the results of research before any marketable product is developed? Do markets (or recognized communities of investors, joint ventures, or customers) exist with respect to these opportunities? If so, do these opportunities vary by industry?[33]

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[32] *Id*.

[33] *See IRS request for information regarding the active trade or business requirement for section 255 separations of entrepreneurial ventures*, IRS (May 6, 2019), https://www.irs.gov/newsroom/irs-request-for-information-regarding-the-active-trade-or-business-requirement-for-section-355-separations-of-entrepreneurial-ventures.

On the Brightside, this study may ultimately lead the IRS to finally allow and entrepreneurial ventures to qualify as active trade or businesses during their research and development stages.[34]

NOL CARRYFORWARDS

Among the changes made by the Tax Cuts and Jobs Act (TCJA) were modifications relating to the treatment of net operating losses (NOL) and certain business losses. TCJA, Section 13302 of the Act, amended section 172 and eliminated the option for most taxpayers to carry back a NOL.[35] Most taxpayers can carry only NOLs that arise from tax years that end after 2017 to a later year. Pre-TCJA law generally allowed for a two-year carryback and 20-year carryforward periods, to the extent not utilized. NOLs not used at the end of the 20-year carryforward period expire. There is an exception for farming losses which can still be carried back two years.[36]

Under new law, the NOL deduction cannot exceed 80% of taxable income (determined without any NOL deduction) for losses developing in tax years starting after 2017. [37] Prior to the amendment there was no limitation, however, NOLs are now being carried forward indefinitely.[38] Pre-TCJA NOLs continue to offset 100% of taxable income.[39] There is now an 80% income offset limitation whereas before it was 100% and there are no longer any carrybacks, but the carryforwards are indefinite.

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[34] *See IRS suspends 1957 rulings on Section 355 ATOB requirement*, PWC (Mar. 28, 2019), https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-irs-suspends-1957-rulings-on-section-355-atob-requirement.pdf.
[35] I.R.S. Publ'n No. 536, Cat. No. 46569U 1 (Jan. 09,2019).
[36] *Id*.
[37] *Id*.
[38] *Id*. at 4.
[39] *Id*. at 7.

Example:

> In 2018, ABC Corporation realizes a loss of $10 million, which gets carried forward to 2019 as an NOL. In 2019, ABC earns taxable income of $10 million. While prior to the TCJA, the full $10 million NOL could be utilized to fully offset the $10 million taxable income. Following the TCJA, the 2018 NOL carryforward is limited to 80% of taxable income, or $8 million. Thus, ABC will have taxable income of $2 million and an NOL carryforward to 2020 of $2 million.[40]

Another situation that may occur is when a corporation has NOL carryforwards that are pre-TCJA, which are NOLs before 2018, and have NOLs in 2018.

Example:

> XYZ Corporation has pre-[TCJA] carryforwards of $13 million and generates a $14 million NOL in 2018. It earns taxable income in 2019 of $15 million. The 80% limitation is thus $12 million [($15 mil x 80% = $12 mil)]. The pre-[TCJA] NOLs of $13 million are not subject to limitation and could be used in full against the $15 million of taxable income, leaving $2 million of taxable income. The $14 million of 2018 NOLs are, however, limited to, 80% of taxable income, or $12 million, and it's doubtful that any may be utilized since the 80% limitation has been surpassed with the pre-TCJA NOLs.[41]

SECTION 199A FINAL REGULATIONS

Final regulations and three related guidelines on the new qualified business income (QBI) deduction (Section 199A deduction) were issued by the Treasury and Internal Revenue Service on January 18, 2019.[42] "The new QBI deduction, created by the 2017 Tax Cuts and Jobs Act (TCJA) allows many owners of sole proprietorships, partnerships, S corporations, trusts, or estates to deduct up to 20 percent of their qualified business income."[43] Taxpayers that qualify for the QBI

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[40] Geoff Kayton, *Changes to Loss Provisions*, BERDONLLP (Jan. 09, 2019), https://www.berdonllp.com/changes-to-loss-provisions/
[41] *Id*.
[42] I.R.S. News Release IR-2019-04 (Jan. 18, 2019).
[43] *Id*.

deduction can also deduct up to 20 percent of their qualified real estate investment trust (REIT) dividends and publicly traded partnership income.[44]

The guidance released in IR-2019-04[45] includes: A set of regulations[46] that finalized last summer's proposed regulations; a new set of proposed regulations[47] providing guidance on multiple QBI deduction, including qualified REIT dividends received by regulated investment companies; a revenue procedure[48] that provides guidance on determining W-2 wages for the purpose of QBI deductions; and, a notice[49] providing a safe harbor for certain real estate enterprises that may be treated as a trade or business for the purposes of the QBI deduction.

Under the final regulations for purposes of section 199A, regulation §1.199A-1(b)(14) defines trade or business "as a trade or business under section 162 (trade or business) other than the trade or business of performing services as an employee."[50] Trades or businesses managed by a disregarded entity shall be treated as managed directly by the owner of the entity for purposes of section 199A.[51]

Proposed regulation 134652-18 amends regulation section 1.199A-3(b)(1)(iv) in order to ensure that such losses are treated as loss from a separate trade or business. "To the extent that losses relate to a PTP, they must be treated as losses from a separate PTP. Section 1.199A-3(b)(1)(iv)(B) provides that attributes of the disallowed loss are determined in the year the loss is incurred."[52] Previously disallowed losses or deductions (including under sections 465, 469, 704(d), and 1366(d)) allowed in the taxable year are generally taken into account for purposes of

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[44] *Id*.
[45] *Id.*
[46] I.R.S. RIN 1545-BO71 (last visited Oct. 11, 2019).
[47] I.R.S. REG-134652-18 (last visited Oct. 11, 2019).
[48] I.R.S. Rev. Proc. 2019-11 (last visited Oct. 11, 2019).
[49] I.R.S. Notice 2019-07 (last visited Oct. 11, 2019).
[50] RIN 1545-BO71 at 12.
[51] *Id*.
[52] REG-134652-18 at 6.

calculating QBI, except to the extent the losses or deductions have been disallowed, suspended, limited, or carried over from taxable years ending before January 1, 2018.[53] Proposed regulation 134652-18 lays down rules for when a RIC that receives a qualified REIT dividend, may pay section 199A dividends.[54] A non-corporate shareholder receiving section 199A dividends that meets the holding period requirements for its shares in the RIC, would treat these dividends as qualified REIT dividends under section 199A(e)(3).[55]

When calculating W-2 wages (for the purposes of QBI deductions) for a taxable year under the methods described in Rev. Proc. 2019-11, include only wages properly reported on Forms W-2 that comply with the applicable rules of regulation section 1.199A-2(b).[56]

Under Revenue Procedure 2019-38,[57] there is a safe harbor that allows certain interests in rental real estate, which include interest in missed-used property, to be treated as a "trade or business" for purposes of the QBI deduction. All requirements have to be met for an interest in a rental real estate to be treated as a single trade or business, and if it fails to satisfy all the requirements it may still be treated as a trade or business for purposes of QBI if it otherwise meets the definition of a trade or business in the regulations of section 199A.[58] For purposes of the QBI deduction, to be treated as a single trade or business it must satisfy the following requirements: (1) taxpayer keeps separate books and records must be maintained to reflect income and expenses for each rental real estate enterprise; (2) if the rental restate enterprise has been in existence less than four year, 250 or more hours of rental services have to be performed to each rental real estate enterprise; (3) the taxpayer attach a statement to a timely filed original return for each taxable year

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[53] *Id*. at 5-6.
[54] *Id*. AT 7-8.
[55] *Id*. at 9.
[56] Rev. Proc. 2019-11 at 3.
[57] I.R.S. Rev. Proc. 2019-38 (last visited Oct. 11, 2019).
[58] *Id*. at 1.

including a description of all rental real estate properties that are included in such rental real estate enterprise; and (4) taxpayer maintains contemporaneous records, including time reports regarding services performed for each rental real estate enterprise.[59] If the rental real estate enterprise has been in existence for at least four years than taxpayer must meet all the same requirements, however with the second requirement, in any three of the five consecutive taxable years that end with the taxable year, 250 or more hours of rental services have to be performed to each rental real estate enterprise.[60]

FINAL REGULATIONS FOR CHARITABLE CONTRIBUTIONS AND STATE AND LOCAL TAX CREDITS

In the IR-2019-109 dated June 11, 2019, the U.S. Department of the Treasury and the Internal Revenue Service has issued final regulations requiring taxpayers to reduce their charitable contribution deductions by any amount of state or local tax credits they receive or expect to receive in return.[61] The final regulations shall apply to contributions made after August 27, 2018 and shall be effective on August 12, 2019.[62] Taxpayers may treat payments made in exchange for such credits as state or local tax payments, which allows some taxpayers to deduct certain of the payments as taxes.[63]

Treasury Decision 9864, finalized the proposed regulations published on August 27, 2018, which were designed to clarify the relationship between state and local tax credits and the federal tax rules on deductions for charitable contributions.[64] In accordance with the final regulations, "a

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[59] *Id*. at 7-9.
[60] *Id*. at 7.
[61] I.R.S. News Release IR-2019-109 (June 11, 2019).
[62] *Id*.
[63] I.R.S. Notice 2019-12 (last visited Oct. 11, 2019).
[64] I.R.S. 84 FR 27513, 27523 (June 13, 2019).

taxpayer making payments to an entity eligible to receive tax-deductible contributions must reduce the federal charitable contribution deduction by the amount of any state or local tax credit that the taxpayer receives or expects to receive in return."[65]

Example:

> If a state grants a 70 percent state tax credit pursuant to a state tax credit program, and an itemizing taxpayer contributes $1,000 pursuant to that program, the taxpayer receives a $700 state tax credit. A taxpayer who itemizes deductions must reduce the $1,000 federal charitable contribution deduction by the $700 state tax credit, leaving a federal charitable contribution deduction of $300.[66]

The final regulation provides exceptions for dollar-for-dollar state tax deductions and for tax credits of no more than 15 percent of the amount transferred.[67] Example: "A taxpayer who receives a state tax deduction of $1,000 for a contribution of $1,000 is not required to reduce the federal charitable contribution deduction to take into account the state tax deduction; and a taxpayer who makes a $1,000 contribution is not required to reduce the $1,000 federal charitable contribution deduction if the state or local tax credit received or expected to be received is no more than $150."[68]

Notice 2019-12,[69] provides a safe harbor under section 164 of the Internal Revenue Code that allows certain individuals who itemize deductions to treat, in certain circumstances, payments that are or will be disallowed as charitable contribution deductions as state or local taxes for federal income tax purposes.[70] Taxpayers may be able to claim a greater SALT deduction by filing an

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[65] News Release IR-2019-109; *see also Final regulations: State and local tax credits and charitable contributions*, KPMG (June 11, 2019) https://home.kpmg/us/en/home/insights/2019/06/tnf-final-regulations-state-and-local-tax-credits-and-charitable-contributions-text-of-regulations.html
[66] News Release IR-2019-109.
[67] *Id*.
[68] *Id*.
[69] Notice 2019-12.
[70] News Release IR-2019-109.

amended return, Form 1040-X, if they have not already claimed the $10,000 maximum amount ($5,000 if married filing separately).[71]

Example 1:

> In year 1, Taxpayer A makes a payment of $500 to an entity described in section 170(c). In return for the payment, A receives a dollar-for-dollar state income tax credit. Prior to application of the credit, A's state income tax liability for year 1 was $500 or more; A applies the $500 credit to A's year 1 state income tax liability. Under section 3 of this notice, A treats the $500 payment as a payment of state income tax in year 1 for purposes of section 164. To determine A's deduction amount, A must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).[72]

Example 2:

> In year 1, Taxpayer B makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, B receives a dollar-for-dollar state income tax credit, which under state law may be carried forward for three taxable years. Prior to application of the credit, B's state income tax liability for year 1 was $5,000; B applies $5,000 of the $7,000 credit to B's year 1 state income tax liability. Under section 3 of this notice, B treats $5,000 of the $7,000 payment as a payment of state income tax in year 1 for purposes of section 164. Prior to application of the remaining credit, B's state income tax liability for year 2 exceeds $2,000; B applies the excess credit of $2,000 to B's year 2 state income tax liability. For year 2, B treats the $2,000 as a payment of state income tax for purposes of section 164. To determine B's deduction amounts in years 1 and 2, B must apply the provisions of section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).[73]

Example 3:

> In year 1, Taxpayer C makes a payment of $7,000 to an entity described in section 170(c). In return for the payment, C receives a local real property tax credit equal to 25 percent of the amount of this payment ($1,750). Prior to application of the credit, C's local real property tax liability in year 1 was $3,500; C applies the $1,750 credit to C's year 1 local real property tax liability. Under section 3 of this notice, for year 1, C treats $1,750 as a payment of local real property tax for purposes of section 164. To determine C's deduction amount, C must apply the provisions of

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[71] *Id*.
[72] Notice 2019-12 at 7.
[73] *Id*. at 7-8.

section 164 applicable to payments of state and local taxes, including the limitation under section 164(b)(6).[74]

REVENUE RULING 2019-11 SALT REFUNDS

Revenue Ruling 2019-11 provides four examples illustrating how the long-standing tax benefit rule interacts with the new SALT limit to determine the portion of any state or local tax refund that must be included on the taxpayer's federal income tax return.[75] "If a taxpayer has received a tax benefit from deducting state or local taxes in a prior taxable year and the taxpayer recovers all or part of those taxes in the current taxable year, the taxpayer must include in gross income the lesser of (1) the difference between the taxpayer's total itemized deductions taken in the prior year and the amount of itemized deductions the taxpayer would have taken in the prior year had the taxpayer paid the proper amount of state and local tax or (2) the difference between the taxpayer's itemized deductions taken in the prior year and the standard deduction amount for the prior year, if the taxpayer was not precluded from taking the standard deduction in the prior year."[76]

ESTATE & GIFT TAX UPDATE SECTIONS 2012 & 2505

"Before the TCJA, the personal exemption [for Estate Tax] was about $5.49 million for individuals and $11.2 for married couples. In 2019, it's $11.4 million per person; for married

[74] *Id*. at 8.
[75] Rev. Rul. 2019-11 (last visited Oct. 11, 2019).
[76] *Id*.

couples, it's $22.8 million."[77] The updated annual exclusion for gifts under Section 2503(b) is $15,000.[78]

[77] Casey Robinson, *How the Tax Cuts and Jobs Act Will Impact Tax Planning in 2019 and Beyond*, KIPLINGER, (Mar. 11, 2019), https://www.kiplinger.com/article/taxes/T055-C032-S014-how-tax-cuts-act-impacts-tax-planning-in-2019-and.html

[78] *What's New – Estate and Gift Tax,* I.R.S. (Sept. 23, 2019) https://www.irs.gov/businesses/small-businesses-self-employed/whats-new-estate-and-gift-tax