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Introduction

On Dec. 22, 2017, President Trump enacted into law Public Law 115-97, which is colloquially, although not technically, called the "Tax Cuts and Jobs Act" (the "Act"). The Act enacts wide-ranging changes to the IRC, such as lowering the individual and corporate rates, creating a brand new deduction for certain non-corporate business, and increasing expensing for certain capital expenditures. Determining the effect of these changes will keep affected taxpayers, along with their accountants and lawyers, busy for a very long time. Less noted, but still important, the Act created new penalty provisions and amended several others, which were perhaps added to the bill in order to offset the revenue loss from some of the headline changes. These provisions and the additional reporting provisions imposed under the Act—both of which could provide traps for the unwary accountant trying to grapple with the new law—are the subject of this short article.

New Provisions

Section 11001(b) of the Act amends IRC section 6695(g). IRC section 6695(g) imposes a penalty on tax return preparers for failing—defined under criteria provided by regulations—to be diligent in determining whether a taxpayer is eligible to claim several different tax credits: $500 for each such failure. The Act adds to the due diligence list the determination of whether or not a taxpayer is entitled to file under head of household status. The same $500 penalty is imposed for each failure by a return preparer to make this determination. The due diligence regulations will need to be updated to provide the criteria for this determination.

One of the highlights of the Act is the enactment of new IRC section 199A, which provides a 20% deduction for qualified business income earned by individuals, trusts, and estates through flow-through entities (e.g., sole proprietorships, partnership, and S corporations). The benefit of the deduction, however, comes with a toll charge—buried in the Act is an amendment to IRC section 6662(d)(1)(C). Generally, IRC section 6662(d) imposes a penalty of 20% of the underpayment of tax if there has been a "substantial understatement of income tax." IRC section 6662(d)(1)(A) defines this term as an understatement that exceeds the greater of either (i) $5,000 or (ii) 10% of the tax required to be shown on the return. Under new IRC section 6662(d)(1)(C), for any taxpayer who claims the IRC section 199A deduction, the 20% penalty is imposed if the understatement of tax exceeds the greater of either (i) $5,000 or (ii) 5% of the tax required to be shown on the return, rather than 10%. This is true regardless of whether the understatement is related to the IRC section 199A deduction.

Section 14401 of the Act imposes an excise tax on certain base erosion payments made by a U.S person to a related foreign payee, and it also authorized new reporting requirements under IRC section 6038A. The U.S. Department of the Treasury has been tasked with writing additional reporting requirements under new IRC section 6038A(b)(2), which could require information with respect to both the paying U.S. corporation and the related foreign corporation receiving the base erosion payment. But more importantly, hidden within this section was an increase to the failure to file penalties on all the foreign forms required under IRC section 6038A. The prior penalty for failure to file Form 5472 was $10,000, and if the failure continued for more than 90 days after the day on which the Secretary of the Treasury mailed notice of such failure, an additional penalty of $10,000 for each 30-day period during which such failure continued after the 90-day period. Now, the penalties have been increased to $25,000 for the initial failure, and then another $25,000 for every 30 days that the failure continues after the 90-day notice period. Interestingly, a similar change was not made to IRC section 6038, so the penalty for failure to file Form 5471 remains at $10,000, as does the continuation penalty.

Finally, the Act creates a new IRC section 6050X, which provides new filing requirements for certain fines, penalties, and remedial payments, and IRC section 6050Y, which creates a new return requirement to report certain life insurance contract transactions. The U.S. Department of the Treasury is tasked with preparing the new forms.

With all the time that will be spent analyzing the Act, it is important to remember that there are dozens of small provisions buried throughout that can impact the upcoming filing season. It will be interesting to see how quickly tax software programs update to include these new requirements. In many cases, we will need to wait for additional guidance from the U.S. Department of the Treasury before understanding how the provisions work. Nevertheless, these provisions are in effect now, and practitioners should keep them in mind.

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