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IRS Reacts To Perceived Loopholes Under The Tax Cuts and Jobs Act

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BY

Taxpayers attempting to take advantage of perceived loopholes in the Tax Cuts and Jobs Act ("TCJA"),beware: the IRS has been quick to respond to positions with which it disagrees. In the most recent example, the IRS released guidance that closed a potential carried interest loophole. In the past few months, similarly, the IRS blocked other TCJA positions regarding the prepayment of taxes and repatriation of foreign earnings.

The IRS recently released guidance closing a potential carried interest loophole. Carried interest represents the portion of an investment fund's return paid to managers of the fund. This return is taxed at a preferential capital gains rate to the managers. The TCJA modified the carried interest rules such that, in order to receive the preferential tax rate, managers must hold the investments for three years.

The TCJA, as written, does not apply the three-year holding period to investments held through a corporation. The TCJA does not define the type of corporation--namely a C corporation or an S Corporation -- to which this exemption applies. Thus, taxpayers seeking to avoid the three-year holding requirement have directed their carried interests to single-member LLCs taxed as S corporations. The IRS has recognized, and disagreed with, this tactic. In a recent notice, the IRS specified that carried interest routed through S corporations will be subject to the same three-year holding requirement as partnerships and non-S Corporation LLCs.

This does not represent the first instance of the IRS disagreeing with potential loopholes in the TCJA. For example, taxpayers anticipating the TCJA’s $10,000 limitation on state and local property taxes attempted to prepay property taxes before the close of 2017. The IRS acted swiftly to limit this deduction by clarifying that such prepayments are deductible only to the extent they have been assessed and there is an existing obligation upon which the taxpayer made payment. Similarly, taxpayers attempting to delay the deemed repatriation tax under the TCJA by electing a shorter tax year met resistance from the IRS. That is, the IRS issued guidance clarifying the circumstances and procedures under which a change in tax year will be approved.

If you have any questions about these or other areas of the TCJA, please reach out to us at Schneider Downs.

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