The Tax Cuts and Jobs Act

Tax Guide

May 2018

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Building a better working world

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Introduction

The Tax Cuts and Jobs Act

Tax Guide

Introduction

The 2017 tax law, commonly known as the “Tax Cuts and Jobs Act” (the Act), has dramatically altered the US tax landscape. Enacted December 22, 2017, the Act provides taxpayers with both challenges and opportunities in the months ahead. All taxpayer groups are affected, although the effects will vary widely based on each taxpayer’s situation. Businesses and individuals alike will need to pay careful attention to technical details, effective dates and forthcoming administrative guidance. Ernst & Young LLP’s Tax Guide to the new law can help.

The Tax Guide is designed to help users quickly find information on the new law. It is organized to be both a high-level reference tool and a gateway to deeper analysis. Information within the Tax Guide is grouped by taxpayer type; users can navigate between sections by clicking on tabs at the bottom of each page.

For those looking for a quick overview of a topic addressed in the law, a page or two within the relevant section briefly summarizes the prior law, new law, effective date and key takeaways. For those wanting a deeper dive into a topic, a “Resources” box on the right side of the page includes links to EY Tax Alerts and other resources.

As additional guidance is published, links will be added to keep users up to date on the latest technical details.

If you have questions about any matter addressed in the Tax Guide or would simply like to discuss the application of the Act to your company, please contact your Ernst & Young LLP Tax account leader, your account team or any other Ernst & Young LLP professional.

Sincerely,

Kate J. Barton

Kathryn Barton
Americas Vice Chair – Tax
Global Vice Chair – Tax, Elect

Michael Mundaca
Co-director of National Tax

Corporate/ business provisions

The Tax Cuts and Jobs Act

Tax Guide

Corporate/business

Corporate rate (IRC Section 11)

Prior law	Imposed a top corporate rate of 35% under a graduated rate structure
New law	Imposes a 21% corporate rate with no graduated rate structure
Effective date	Effective for tax years beginning after 2017, but a "blended" rate applies for fiscal-year taxpayers with a fiscal year that includes 1 January 2018
Implications/ key takeaway	Explore opportunities for accelerating the use of losses and credits to maximize the benefit of such attributes

Resources

See a detailed description of this provision

Tax Alert 2017-2148

Joint Explanatory Statement p.174

Legislative text (H.R. 1-43)

Notice 2018-38

Dividends received deduction (DRD) (IRC Section 243)

Prior law

- Allowed C corporations that received dividends from certain taxable domestic corporations to receive either an 80% or 70% deduction on the dividends received

New law

- Lowers the 80% DRD to 65% and the 70% DRD to 50% after 2017

Effective date

- Effective for tax years beginning after 2017

Implications/ key takeaways

- Review existing tax receivable agreements, which may have been based on the prior (higher) DRD, to determine how the change affects their value
- Revisit accumulated earnings tax and personal holding company provisions

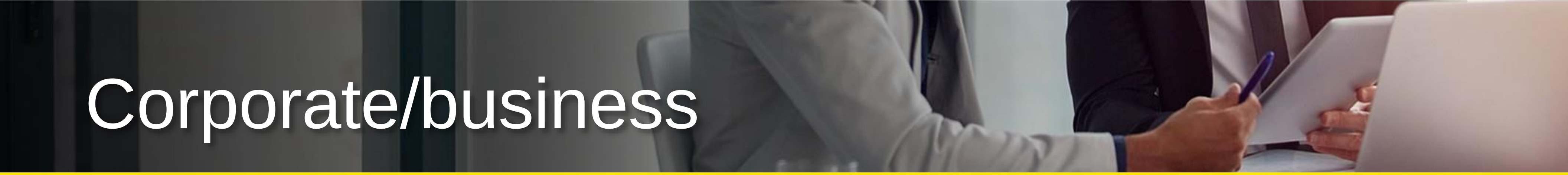
Resources

See a detailed description of this provision

Tax Alert 2017-2148

Joint Explanatory Statement p.175

Legislative text (H.R. 1-47)



Corporate/business

Alternative minimum tax (AMT) (IRC Section 55)

Prior law

- Imposed an AMT on a corporation in an amount by which the tentative minimum tax exceeds the regular income tax for the tax year

New law

- Repeals the AMT
- Allows taxpayers with an AMT credit to use the credit to offset regular tax liability
- Allows taxpayers to claim a refund of 50% (100% for years beginning in 2021) of the remaining credits (to the extent the credits exceed regular tax for the year) in tax years beginning before 2022

Effective date

- Effective for tax years beginning after 2017, but a "blended" rate applies for fiscal-year taxpayers with a fiscal year that includes 1 January 2018

Implications/ key takeaways

- Consider allocating AMT credits among consolidated return members upon a carve-out (including prior transactions)
- Consider allocating benefits between buyers and sellers

Resources

See a detailed description of this provision

Tax Alert 2017-2130

Joint Explanatory Statement p.148

Legislative text (H.R. 1-39)

Notice 2018-38

Expensing (IRC Section 179)

Prior law

- Allowed taxpayers to expense up to $510,000 in qualified property costs placed in service during the tax year under Section 179
- Reduced the $510,000 limit by the amount by which the costs of the qualified properties exceeded $2,030,000

New law

- Increases the maximum expensing under Section 179 to $1 million
- Increases the phase-out threshold amount to $2.5 million
- Modifies the definition of qualified real property under Section 179(f) to include qualified improvement property and improvements to roofs, HVAC, fire protection and alarm systems, and security systems, provided certain requirements are met

Effective date

- Effective for tax years beginning after 2017

Implications/ key takeaway

- Explore how immediate expensing might be available under Section 179 for investments in certain “qualified real property”

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.212

Legislative text (H.R. 1-48)

Corporate/business

Simplified accounting for small businesses (IRC Section 448(c))

Prior law

- Allowed C corporations and partnerships with a C corporation partner to use the cash method if they had average annual gross receipts of $5 million or less during all prior years

New law

- Increases the threshold to annual average gross receipts of $25 million for the three prior years for C corporations, partnerships and any farming C corporation (or farming partnership with a C corporation partner)
- Repeals requirement that those businesses satisfy the requirement for all prior years

Effective date

- Effective for tax years beginning after 2017

Implications/ key takeaway

- Expands eligibility for cash method of accounting
- Evaluate eligibility for cash method of accounting

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.215

Legislative text (H.R. 1-49)

Corporate/business

Qualified property expensing (IRC Section 168(k))

Prior law

- Allowed taxpayers to claim bonus depreciation under Section 168(k) in the year in which qualified property is placed in service through 2019
- Allowed 50% bonus depreciation in 2017, phased down to 40% in 2018 and 30% in 2019

New law

- Allows taxpayers to claim 100% bonus depreciation on qualified property
- Phases down after 2022: 80% for property placed in service during 2023; 60% for 2024; 40% for 2025; and 20% for 2026
- Allows prior law treatment for property not covered under the new law
- Establishes special phase-down rules for certain property
- Expands the definition of qualified property to include used property, qualified film, television and live theatrical productions and certain used property
- Treats "qualified improvement property" placed in service after 31 December 2017 as recoverable over 39 years, contrary to the legislative intent expressed in the Joint Explanatory Statement

Resources

[See a detailed description of this provision]

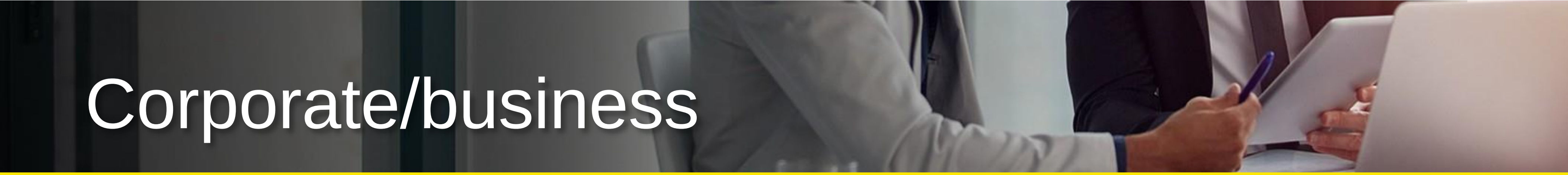
[Tax Alert 2017-2131]

[Tax Alert 2018-0012]

[Tax Alert 2018-0394]

[Joint Explanatory Statement p.181]

[Legislative text (H.R. 1-52)]



Corporate/business

Qualified property expensing (IRC Section 168(k)) (cont.)

Effective date

- Effective for qualified property acquired and placed in service after 27 September 2017
- Does not treat property as acquired after the date on which a binding written contract is entered for such acquisition
- Effective for qualified improvement property placed in service after 31 December 2017

Implications/ key takeaways

- Consider electing not apply the Section 168(k) provisions if in a loss position and would not otherwise benefit from immediate expensing of qualified property and, instead, use the depreciation provisions of Section 168
- Model out the impact that depreciation elections will have on interest deductibility

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Tax Alert 2018-0012

Tax Alert 2018-0394

Joint Explanatory Statement p.181

Legislative text (H.R. 1-52)

Corporate/business

Interest limitation (IRC Section 163(j))

Prior law	‣ Allowed business interest as a deduction in the tax year in which the interest was paid or accrued, subject to limitation rules, as applicable

New law	‣ Limits net interest expense deduction to 30% of the business's adjusted taxable income (generally, EBITDA through 2021)
	‣ Does not apply to:
	  ‣ Taxpayers with average annual gross receipts of $25 million or less for the three tax-year period ending with the prior tax year that does not exceed $25 million
	  ‣ Certain utilities
	‣ Allows real property trades or businesses and farms to elect not to apply the limitation
	‣ Applies to S corporations and partnerships at the entity level

Effective date	‣ Effective for tax years beginning after 2017
Implications/ key takeaways	‣ Consider decreasing interest expense by converting non-deductible interest expense into deductible non-interest expense ‣ Consider increasing interest income by converting taxable non-interest income into interest income ‣ Explore use of financial products, as well as changes to a variety of ordinary-course business arrangements

Resources

See a detailed description of this provision

Tax Alert 2017-2148

Tax Alert 2018-0750

Joint Explanatory Statement p.226

Legislative text (H.R. 1-64)

Net operating losses (NOLs) (Section 172)

Prior law

- Allowed 2-year carryback/20-year carryforward of NOLs

New law

- Limits deduction to 80% of the taxpayer's taxable income (determined without regard to the NOLs)
- Repeals two-year carryback, except for certain farming losses, but NOLs may be carried forward indefinitely
- Repeals Section 172(f), the special rule allowing a 10-year carryback of specified liability losses

Effective date

- Effective for losses arising in tax years beginning after 2017 for purposes of the 80% limit
- Effective for losses ending after 31 December 2017 for purposes of the repeal of the carryback and the allowance of the unlimited carryforward

Implications/ key takeaway

- Results in no longer being able to rely on specified liability losses as a source of cash tax savings for eligible liabilities that generate losses in tax years beginning after 31 December 2017
- Precludes carrybacks for fiscal-year companies whose tax year includes 31 December 2017

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.234

Legislative text (H.R. 1-68)

Like-kind exchanges (LKEs) (Section 1031)

Prior law

- Allowed nonrecognition of gain/loss if property held for use in a trade or business or for investment is exchanged for property of a like kind that is to be held in a trade or business or for investment

New law

- Limits the nonrecognition of gain/loss in LKEs to those involving real property only
- Applies current law to LKEs if the taxpayer disposed of or received the property in the exchange on or before 31 December 2017

Effective date

- Effective for LKEs completed after 2017, with a transition rule for LKEs initiated, but not completed, before 31 December 2017

Implications/ key takeaway

- Consider offsetting the taxpayer-unfavorable impact of not being able to use Section 1031 by using the immediate expensing provisions set forth in amended Section 168(k)

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.236

Legislative text (H.R. 1-70)

Corporate/business

Local lobbying expense deduction (Section 162(e))

Prior law	Permitted taxpayers to deduct lobbying expenses for legislation before local government bodies as ordinary and necessary business expenses
New law	Repeals local lobbying expense deduction
Effective date	Effective for amounts paid or incurred on or after 22 December 2017
Implications/ key takeaway	Consider how to properly identify lobbying activities and expenses that are no longer tax-deductible

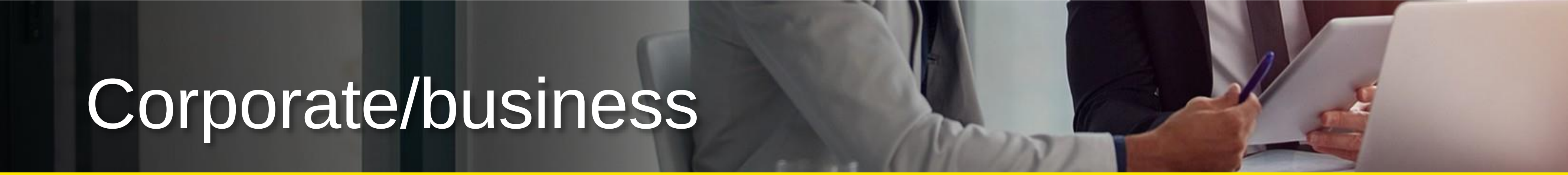
Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.242

Legislative text (H.R. 1-76)



Corporate/business

Domestic production deduction (Section 199)

Prior law

- Allowed a deduction equal to 9% of the lesser of qualified production activities income (6% for such oil-related income) of the lesser of the taxpayer's taxable or qualified production activities income subject to a limitation of 50% of W-2 wages paid by the taxpayer during the calendar year that are allocable to the taxpayer's domestic production gross receipts

New law

- Repeals domestic production activities deduction

Effective date

- Effective for tax years beginning after 31 December 2017

Implications/ key takeaways

- Review activities to determine whether they qualify
- Review the calculation to ensure the deduction is maximized
- Consider filing amended returns for open tax years beginning before1 January 2018

Resources

[Tax Alert 2017-2131]

[Joint Explanatory Statement p.244]

[Legislative text (H.R. 1-73)]

Entertainment expenses and fringe benefits (IRC Sections 132(g) and 274)

Prior law

- Allowed 50% deduction for: (i) business meals and beverages; (ii) entertainment, amusement or recreation activities, or facilities (including membership dues)
- Allowed 100% deduction for: (i) qualified employee recreational expenses; (ii) fringe benefits (e.g., transportation, employer-operated eating facility), even if excluded from the employee's income; (iii) employer-operated eating facilities (including meals at facility for employer's convenience), and (iv) goods, services and facilities to the extent reported as compensation to an employee or income of non-employee
- Permitted employees to exclude qualified moving expense reimbursements from income

New law

- Retains 50% deduction for qualifying non-entertainment business meals and beverages
- Reduces to 50% deduction for employer-operated eating facilities (and eliminates deduction in 2026, along with deduction for meals for the employer's convenience)
- Repeals deduction for: (i) entertainment activities and membership dues; and (ii) transportation, commuting or subsidized parking expenses (including pre-tax salary reductions) of employees (except if necessary for employee safety)
- Repeals employee income exclusion for qualified moving expense reimbursements

Resources

See a detailed description of this provision

Tax Alert 2017-2160

Tax Alert 2018-0143

Tax Alert 2018-0541

Joint Explanatory Statement p.246

Legislative text (H.R. 1-71)

Webcast: Entertainment and expenses and fringe benefits

Entertainment expenses and fringe benefits (IRC Sections 132(g) and 274) (cont.)

Effective date

- Effective for amounts paid or incurred after 31 December 2017

Implications/ key takeaways

- Consider whether certain activities may qualify for one of the exceptions to the Section 274 disallowance, e.g., employers may be able to structure activities to be treated as recreational expenses for employees, or as employee business meetings
- Determine whether continuing to offer qualified transportation fringe benefits, including subsidized parking, to employees, whether through a salary reduction or otherwise, continues to make sense for the organization for reasons other than tax efficiency

Resources

See a detailed description of this provision

Tax Alert 2017-2160

Tax Alert 2018-0143

Tax Alert 2018-0541

Joint Explanatory Statement p.246

Legislative text (H.R. 1-71)

Webcast: Entertainment and expenses and fringe benefits

Special rules for tax year of inclusion (IRC Section 451)

Prior law

- Required a cash-basis taxpayer to include an amount in income when it is actually or constructively received
- Required an accrual-basis taxpayer to include an amount in income when all events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy

New law

- Requires an accrual-method taxpayer to recognize income subject to the all-events test no later than the tax year in which the income is taken into account on the taxpayer's financial statements
- Applies in lieu of the original issue discount (OID) rules
- Establishes an allocation of the transaction price for contracts with multiple performance obligations
- Codifies current deferral method of accounting for advance payments for goods and services under Revenue Procedure 2004-34, allowing taxpayers to defer inclusion of income associated with certain advance payments to end of tax year following tax year of receipt if such income is deferred for financial statement purposes
- Does not apply to:
  - Special methods of accounting, such as those for long-term contracts and installment sales
  - Any item of gross income connected with a mortgage servicing contract

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Tax Alert 2018-0882

Joint Explanatory Statement p.272

Legislative text (H.R. 1-60)

Special rules for tax year of inclusion (IRC Section 451) (cont.)

Effective date

- Effective for tax years beginning after 2017

Implications/ key takeaways

- Results in an earlier accrual of income to the extent amounts are accrued earlier for financial statement purposes
- Consider this provision in conjunction with ASC 606 adoption, as the potential for an acceleration of taxable income exists

Resources

[See a detailed description of this provision](#)

[Tax Alert 2017-2131](#)

[Joint Explanatory Statement p.272](#)

[Legislative text (H.R. 1-60)](#)

Nondeductibility of amounts paid to government as part of an investigation (IRC Section 162(f))

Prior law

- Denied deductions for any fine or penalty paid to a government for the violation of any law

New law

- Maintains denial of deduction, but expands and codifies certain rules
  - Expands the definition of "governmental entities" to include certain nongovernmental regulatory entities
  - Clarifies that a violation of law may include a governmental investigation or inquiry
  - Provides specific rules and requirements for amounts constituting restitution

Effective date

- Generally effective for amounts paid or incurred after 22 December 2017
- Will not apply to amounts paid or incurred under a binding order or agreement entered into before 22 December 2017 unless an order or agreement required court approval and the approval was not obtained before that date

Implications/ key takeaway

- Places increased importance on tax department involvement in the investigation and settlement process to support the deductibility of amounts

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Tax Alert 2018-0687

Joint Explanatory Statement p.277

Legislative text (H.R. 1-73)

Amortization of research or experimental (R&E) expenditures (IRC Section 174)

Prior law	- Allowed taxpayers to treat R&E expenditures as deductible expenses, or to elect to capitalize and amortize these expenditures ratably over no less than 60 months - Allowed alternative election to amortize research expenditures over 10 years
New law	- Requires R&E expenditures to be capitalized and amortized over 5 years (15 years for R&E conducted outside the United States) - Requires software development expenditures to be treated as R&E expenditures - Requires any capitalized R&E expenditures related to property that is retired, disposed of, or abandoned to be amortized over the remaining amortization period
Effective date	- Effective for expenses incurred in tax years beginning after 2021
Implications/ key takeaway	- Removes the ability for taxpayers to recover costs incurred for research and development (R&D) in the year they are incurred, a considerably negative impact for taxpayers currently treating such costs as deductible expenses

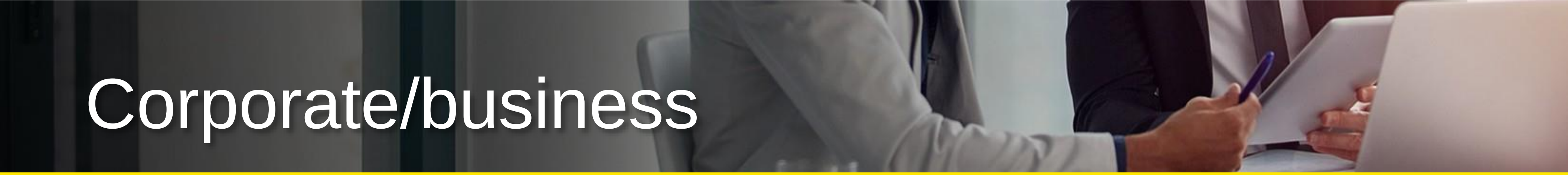
Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.269

Legislative text (H.R. 1-58)



Corporate/business

Character of self-created property (IRC Section 1221(a)(3))

Prior law

- Treated certain self-created property (i.e., self-created patent, invention, model, design, secret formula or process) as a capital asset

New law

- Repeals the rule that treated a self-created patent, invention, model or design, or secret formula or process as a capital asset
- Treats gains or losses from the sale or exchange of that self-created property as ordinary in character

Effective date

- Effective for dispositions after 31 December 2017

Implications/ key takeaway

- Subjects self-created property to higher ordinary tax rates

Resources

See a detailed description of this provision

Tax Alert 2017-2131

Joint Explanatory Statement p.258

Legislative text (H.R. 1-80)

Pass-through deduction (IRC Section 199A)

Prior law

- Flow-through income taxed at individual rates

New law

- Adds a 20% deduction on certain domestic trade or business income
- Allows a 20% deduction for certain dividends received from REITs and cooperatives
- Limits deduction amount based on W-2 wages/depreciable assets used in the trade or business
- Does not apply to certain service-based income (subject to phase-ins and phase-outs for individuals with income starting at $157,500 ($315,000 for married persons filing jointly))

Effective date

- Effective for tax years beginning after 2017
- Sunsets 31 December 2025

Implications/ key takeaways

- Reflects Congress' attempt to mitigate the difference between the tax rate applicable to individuals' business income and the tax rate applicable to C corporations' income
- Results in an effective 29.6% individual top tax rate on qualifying income
- Does not fully mitigate increase in federal income tax rate differential between business earnings taxed to a C corporation versus business earnings taxed to individuals, trusts and estates
- May prompt businesses whose earnings are taxed to individuals, trusts or estates to consider becoming C corporations

Resources

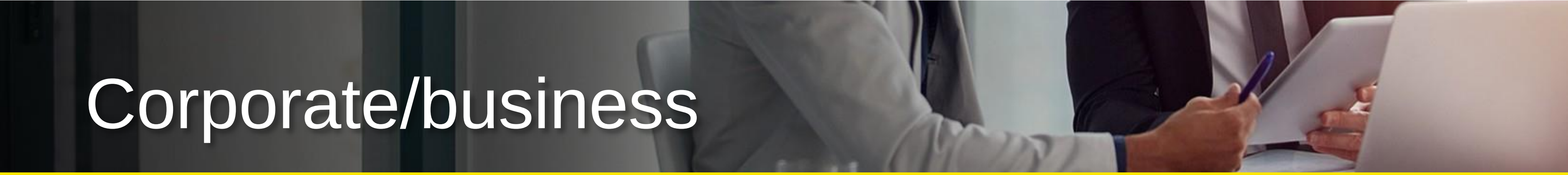
See a detailed description of this provision

Tax Alert 2017-2141

Tax Alert 2017-2167

Joint Explanatory Statement p.20

Legislative text (H.R. 1-10)



Corporate/business

Carried interest (IRC Section 1061)

Prior law

- Taxed carried interest capital gains held for more than one year at a rate of 23.8% (20% long-term capital gain rate, plus 3.8% investment tax)

New law

- Imposes a three-year holding period to treat capital gain as long-term capital for certain partnership interests held in connection with the performance of certain services

Effective date

- Effective for tax years beginning after 2017

Implications/ key takeaway

- May not result in a significant amount of recharacterization of long-term capital gain into short-term capital gain because most of the capital assets would be held for three years or more in the normal course of business

Resources

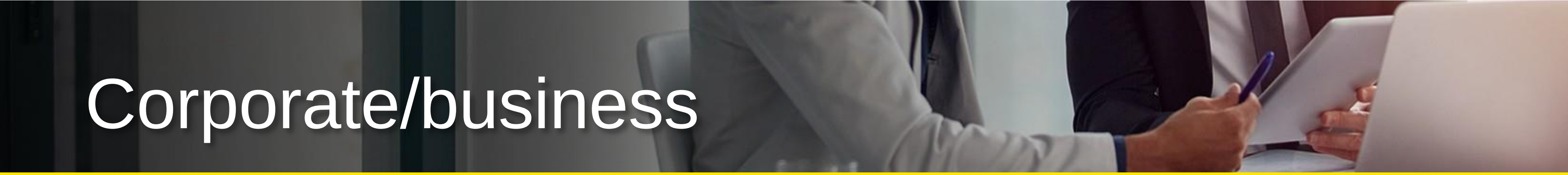
See a detailed description of this provision

Tax Alert 2017-2174

Tax Alert 2018-0512

Joint Explanatory Statement p.262

Legislative text (H.R. 1-77)



Corporate/business

Business loss limitation (IRC Section 461(l))

Prior law

- Imposed multiple limits on a sole proprietor, partner's or S corporation shareholder's ability to claim losses from business operations

New law

- Creates an additional limit on the ability to claim business losses by disallowing losses over $500,000 for joint filers, $250,000 for all other filers, indexed for inflation
- Converts the disallowed loss to an NOL to be used in the following year

Effective date

- Effective for tax years beginning after 2017
- Sunsets 31 December 2025

Implications/ key takeaway

- May make operating as a pass-through entity less attractive than it is currently, as the limitation prevents sole proprietors, partners and S corporation shareholders from utilizing business losses exceeding the limitation against other sources of income

Resources

See a detailed description of this provision

Tax Alert 2017-2141

Tax Alert 2017-2167

Joint Explanatory Statement p.56

Legislative text (H.R. 1-18)

Corporate/business

Sale of partnership interest by foreign partner (IRC Section 864(c))

Prior law

- Was uncertain regarding the tax treatment of effectively connected gain or loss from a foreign partner's sale of a partnership interest

New law

- Treats gain or loss on a foreign partner's sale or exchange of a partnership interest as effectively connected with a US trade or business to the extent of transferor's share of effectively connected gain or loss
- May create withholding requirement for buyer and partnership

Effective date

- Effective for sales and exchanges on or after 27 November 2017

Implications/ key takeaways

- Requires partnerships to withhold distributions to the transferee partner to the extent the transferee failed to withhold properly
- Requires transferees (buyers) to withhold 10% from gross proceeds paid for partnership interests subject to the new tax, and partnerships to withhold from distributions to the transferee partner to the extent the transferee failed to withhold properly
- Requires foreign sellers of partnership interests to file US income tax returns to report and pay the new tax, even if proceeds were subjected to withholding
- May cause foreign investors with long-standing positions in a publicly traded partnership (PTP) to suddenly owe US tax on the sale of their PTP interests, which could result in an economic loss, depending on the creditability of the US tax in their home countries

Resources

See a detailed description of this provision

Tax Alert 2017-2174

Tax Alert 2018-0788

Joint Explanatory Statement p.366

Legislative text (H.R. 1-85)

Built-in loss definition on partnership loss transfers (IRC Section 743(d))

Prior law	Required a partnership to adjust the basis in its assets upon the sale of a partnership interest only if the partnership had a built-in loss of more than $250,000 in its assets
New law	Broadens the current requirement by also requiring a basis adjustment if the partner selling a partnership interest would be allocated a loss of more than $250,000 upon a hypothetical taxable disposition by the partnership of all of the partnership's assets for cash equal to the assets' fair market value
Effective date	Effective for transfers of partnership interests after 31 December 2017
Implications/ key takeaway	Expands the application of mandatory downward basis adjustments on transfers of partnership interests by taking into account gain and loss allocations to the transferee

Resources

See a detailed description of this provision

Tax Alert 2017-2174

Joint Explanatory Statement p.369

Legislative text (H.R. 1-88)

Limitation on excessive employee remuneration (IRC Section 162(m))

Prior law

- Limited the compensation deduction for amounts paid to a public company's "covered employees" to $1 million, which included the CEO and the next three highest compensated officers, but not the CFO
- Excluded officers who were not employed on the last day of the year from the definition of covered employee
- Did not apply to performance-based compensation and commissions

New law

- Expands definition of publicly traded companies that are subject to the deduction limitation
- Expands definition of covered employee to include: CFO, CEO and the three most highly compensated officers for the tax year, and eliminates the employed-on-the-last-day rule
- Deems former covered employees to be covered employees
- Repeals the exception for performance-based compensation and commissions

Effective date

- Effective for tax years beginning after 2017
- Provides a transition rule for written binding contracts in effect on 2 November 2017 provided they are not materially modified

Implications/ key takeaway

- Reconsider the structure of senior executive compensation programs

Resources

See a detailed description of this provision

Tax Alert 2017-2160

Joint Explanatory Statement p.341

Legislative text (H.R. 1-102)

Corporate/business

Other adjusted provisions

Accounting for inventories

Exempts businesses with average gross receipts of $25 million or less from the requirement to maintain inventories beginning after 2017

Uniform capitalization

Exempts businesses with average gross receipts of $25 million or less from the UNICAP rules beginning after 2017

Long-term contracts

Increases the average gross receipts exception to the percentage-of-completion method to $25 million; applies to contracts entered into after 2017

Luxury automobiles

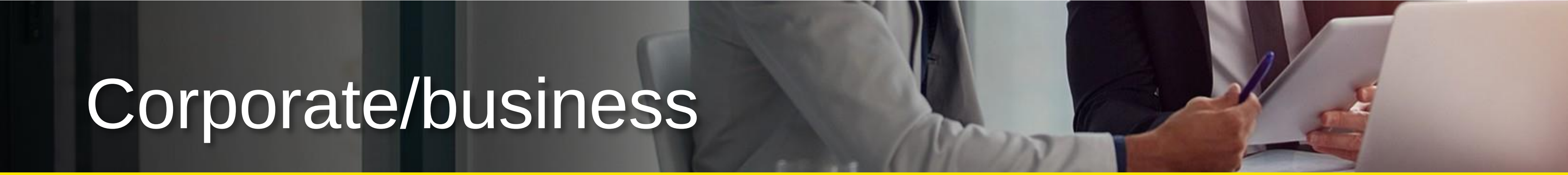
Increases allowable depreciation for certain passenger automobiles to $10,000 for the year in which the vehicle is placed in service ($18,000 for passenger automobiles subject to bonus depreciation), with increased allowable depreciation in proceeding years

Real property cost recovery

Shortens recovery period of residential rental property to 30 years for alternative depreciation system (ADS) purposes; requires real property trades/businesses electing out of interest limitations under Section 163(j) to use ADS to recover nonresidential real property, residential rental property and qualified improvement property

Farm property depreciation

Shortens the recovery period from seven to five years and removes the requirement to use the 150% declining balance recovery method for any machinery or equipment used in a farming business whose original use commences with the taxpayer and is placed in service after 2017



Corporate/business

Other adjusted provisions (cont.)

Limitation on partner losses

Modifies the basis limitation on partner losses to include as losses the partner's share of partnership charitable contributions and foreign taxes

US territory sourcing rules

Modifies the US income limitation to exclude only US-source (or effectively connected) income attributable to a US office or fixed place of business

S to C corporate conversion

Allows an eligible terminated S corporation that must switch to the accrual method of accounting to take a Section 481 adjustment over six years and treats a portion of dividends paid by an eligible terminated S corporation after its post-termination transition period as coming from its accumulated adjustments account, which would generally be tax-free to the shareholders

Qualified equity grants

Allows qualified employees to elect to defer income attributable to a stock option or restricted stock unit of a private corporation; ends deferral when stock is transferable or tradeable, or five years after transfer of stock

Electing small business trust

Allows a nonresident alien individual to be a potential current beneficiary of an ESBT and modifies the rule affecting an ESBT's ability to claim a charitable contribution deduction

Capital contributions

Modifies Section 118 to subject certain capital contributions to tax, such as contributions in aid of construction

Corporate/business

Other adjusted provisions (cont.)

Rehabilitation credit

Repeals 10% credit for pre-1936 buildings, but keeps the 20% credit for expenses to rehabilitate certain historic structures (taken ratably over five years)

Orphan drug credit

Limits the orphan drug credit to 27.5% of the qualified clinical testing expenses; effective for amounts paid or incurred in tax years beginning after 2017

Medical leave credit

Allows tax credit of 12.5% of wages paid to employees on family/medical leave; applicable against AMT; sunsets 31 December 2019

Low-income housing credit

Modifies credit to be more favorable for housing in certain rural areas; provides an offset by reducing the allowance for housing in high-cost areas

Qualified opportunity zones

Allows temporary deferral of capital gains reinvested in a qualified opportunity fund and the permanent exclusion of capital gains from the sale or exchange of an investment in the qualified opportunity fund

Corporate/business

Other adjusted provisions (cont.)

Backup withholding rate

Decreases backup withholding rate from 28% to 24%, effective for payments made after 31 December 2017

Aircraft management services

Exempts certain payments related to the management of private aircraft from the excise taxes imposed on taxable transportation by air

Sexual harassment NDA

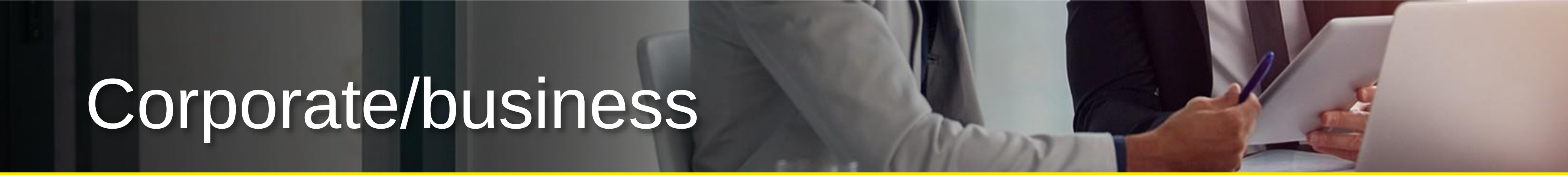
Denies deduction for any settlement, payout or attorney fees related to sexual harassment or abuse if the settlement or payment is subject to a nondisclosure agreement (NDA); effective for amounts paid or incurred after enactment

Excise taxes on beer and wine

Reduces federal beer excise tax from $18 per barrel to $16 per barrel on first six million barrels; lowers tax rate on small brewers from $7 per barrel to $3.50 per barrel on the first 60,000 barrels; lowers tax rates on wine and expands application of the wine producer's credit to all domestic producers and importers; provides a mechanism to assign the reduced tax rates to beer and wine importers; sunsets 31 December 2019

Excise taxes on distilled spirits

Replaces the $13.50 per gallon tax rate on all distilled spirits with a three-tiered rate system of $2.70 per proof gallon of 100,000 gallons or less, $13.34 for proof gallons of 22,130,000 or less and $13.50 for proof gallons over 22,130,000; provides a mechanism to assign the reduced tax rates to distilled spirits importers upon receipt; allows importers that receive tax credit assignments or reduced tax rates from a foreign manufacturer to be considered a US controlled group member for purposes of applying the tax; sunsets on 31 December 2019



Corporate/business

Significant retained provisions

Research credit

Retains research credit equal to sum of 20% of excess of qualified research expenses over a base amount, plus qualified basic research payments and payments to qualified energy consortia

New markets tax credit

Retains credit for investments in qualified community development entities, which generally intend to serve low-income communities and individuals; still expires after 2019

American Samoa economic development credit

Retains credit based on the corporation's economic activity-based limitation with respect to American Samoa

Unused business credits

Retains 1-year carryback and 20-year carryforward of general business credits (GBCs), as well as the deduction for unutilized GBCs

Corporate/business

Significant retained provisions (cont.)

Oil and gas from marginal wells

Retains $3-per-barrel credit for production of crude oil and a 50-cent-per-1,000-cubic-feet credit for production of qualified natural gas

Oil recovery credit

Retains credit equal to 15% of enhanced oil recovery costs

Production tax credit

Retains production tax credit for the production of electricity from qualified energy resources at a qualified facility during the 10-year period after the facility was placed in service

Percentage depletion

Retains depletion allowance deduction for eligible mining companies and oil and gas companies (among others), which may generally claim the greater of cost depletion or percentage depletion, subject to numerous limitations and restrictions

Nuclear power facilities

Retains credit for electricity produced at a qualifying advanced nuclear power facility for an eight-year period beginning on the date the facility is placed in service

Energy investment tax credit (ITC)

Retains permanent, nonrefundable 10% ITC for the cost of eligible energy property when placed in service

Corporate/business

Significant retained provisions (cont.)

Work opportunity tax credit

Retains credit equal to 40% of qualified first-year wages of employees belonging to certain targeted groups; still expires after 2019

FICA taxes on tips

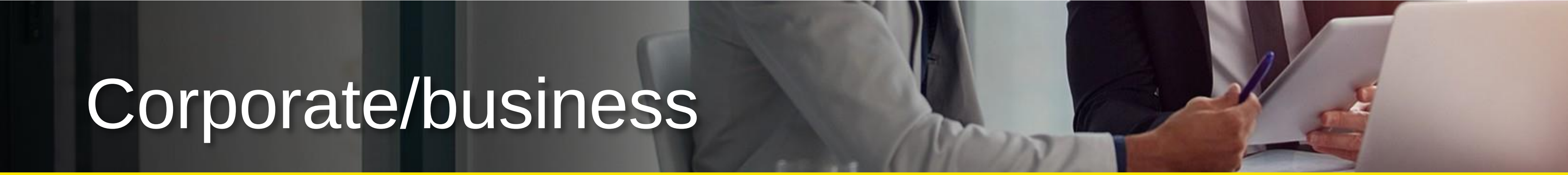
Retains income tax credit for employers equal to employer's share of FICA taxes attributable to tips received from customers in connection with provision of food or beverages

Employer child tax credit

Retains employer credit equal to 25% of qualified expenses for employee child care and 10% of qualified expenses for child-care resource and referral services (limited to $150,000 per tax year)

Disabled access credit

Retains 50% credit per year for expenditures between $250 and $10,250 by small-business taxpayers to provide access for disabled individuals



Corporate/business

Significant retained provisions (cont.)

Private activity bonds

Retains current law under which interest on private activity bonds is excluded from gross income, subject to certain requirements

Cover over of rum excise taxes

Retains limit of $10.50 per proof gallon ($13.25 per gallon before 1 January 2017) for cover over (payment) to Puerto Rico and the Virgin Islands of excise tax on rum imported into US

Contingency fee cases

Retains prior law regarding deductibility of law-firm expense advances made on behalf of clients in the context of contingent-fee cases

Corporate/business

Significant repealed provisions

Section 199

Repeals the domestic production activities deduction, effective for tax years beginning after 31 December 2017

Technical terminations of partnerships

Repeals Section 708(b)(1)(B), under which sale or exchange of 50% or more of interests in partnership capital and profits within a 12-month period causes a "technical termination"

Lobbying deduction

Repeals local lobbying expense deduction for amounts paid or incurred on or after 22 December 2017

Tax credit bonds

Repeals authority to issue tax credit bonds effective for bonds issued after 2017

Advance refunding bonds

Repeals exclusion from income for interest on advance refunding bonds for bonds issued after 2017

Publicly traded securities gain

Repeals roll over, without recognition of income, of capital gains on sale of publicly traded securities when proceeds are used to purchase stock in specialized small business investment corporation within 60 days

International provisions

The Tax Cuts and Jobs Act
Tax Guide

Dividends received from foreign subsidiaries (IRC Section 245A)

Prior law

- Imposed tax on US multinational companies' worldwide income, but allowed deferral of US tax on foreign active business income earned by foreign corporate subsidiaries until repatriated

New law

- Exempts 100% of foreign-source portion of dividends (excluding hybrid dividends) received by a US corporation from a foreign corporation (other than a passive foreign investment company (PFIC) that is not also a controlled foreign corporation (CFC)) in which the US corporation owns at least a 10% stake and meets applicable holding period requirements
- Does not apply to foreign branch income or gain from the sale of foreign branches or foreign subsidiary stock (with limited exceptions)

Effective date

- Effective for distributions made after 31 December 2017

Implications/ key takeaways

- Aims to increase the global competitiveness of US companies, while also enabling them to bring home foreign earnings to invest domestically

Resources

See a detailed description of this provision

Tax Alert 2017-2166

Joint Explanatory Statement p.466

Legislative text (H.R. 1-136)

Webcast: International tax changes under tax reform

Transition tax (IRC Section 965)

Prior law

- Allowed deferral of US tax on foreign active business income earned by foreign corporate subsidiaries until repatriated, leading to the accumulation of untaxed foreign earnings

New law

- Imposes a one-time transition tax on a 10% US shareholder's pro rata share of the foreign corporation's accumulated post-1986 deferred foreign income, at the rate of 15.5%, to the extent of the US shareholder's aggregate foreign cash position, and 8% for the remainder

Effective date

- Effective for the last tax year of foreign corporations beginning before 1 January 2018 and for the tax years of a US shareholder with or within which such tax years end

Implications/ key takeaways

- Creates an upfront cost for US multinational companies before they receive the benefits of the new quasi territorial tax system
- Consider E&P studies, gather documentation for foreign tax pool balances and determine aggregate foreign cash position

Resources

- See a detailed description of this provision
- Tax Alert 2017-2166
- Tax Alert 2018-0366
- Tax Alert 2018-0602
- Tax Alert 2018-0622
- Tax Alert 2018-0751
- Joint Explanatory Statement p.477
- Legislative text (H.R. 1-142)
- Webcast: International tax changes under tax reform

Global intangible low-taxed income (GILTI) (IRC Section 951A)

Prior law

- Required a US shareholder of a controlled foreign corporation (CFC) to include annually in gross income its pro rata share of the CFC's "subpart F income," but allowed the US shareholder to defer the inclusion of other CFC income in gross income before a distribution (or deemed distribution) from the CFC

New law

- Requires a US shareholder to include annually in gross income the US shareholder's GILTI, which loosely correlates with the US shareholder's aggregate pro rata shares of the US shareholder's CFCs' "other income" (deferrable under prior law), reduced by certain deficits and a "deemed tangible return" amount calculated with reference to the CFCs' basis in certain depreciable tangible property
- Allows a corporate US shareholder a deduction generally equal to 50% (37.5% for tax years beginning after 2025) of its GILTI inclusion, reduced to the extent that other deductions would otherwise effectively reduce the US shareholder's taxable GILTI inclusion
- Deems a corporate US shareholder to have paid 80% of certain foreign income taxes paid by its CFCs in connection with a GILTI inclusion
- Allows the deemed-paid taxes to be taken as a credit against US tax payable with respect to the GILTI inclusion (but not other income, and only in that year)

Resources

See a detailed description of this provision

Tax Alert 2017-2166

Joint Explanatory Statement p.509

Legislative text (H.R. 1-155)

Webcast: International tax changes under tax reform

Global intangible low-taxed income (GILTI) (IRC Section 951A) (cont.)

Effective date

- Effective for tax years of a foreign corporation beginning after 31 December 2017, and for the tax years of a US shareholder with or within which such tax years end

Implications/ key takeaway

- Effectively establishes a global minimum tax on foreign earnings generated in CFCs, irrespective of repatriation back to a US shareholder — other than the CFCs' deemed tangible return

Resources

[See a detailed description of this provision](#)

[Tax Alert 2017-2166](#)

[Joint Explanatory Statement p.509](#)

[Legislative text (H.R. 1-155)](#)

[Webcast: International tax changes under tax reform](#)

Deduction for foreign-derived intangible income (FDII) (IRC Section 250) and GILTI (IRC Section 951A)

Prior law	Did not include any similar provision
New law	Allows a domestic corporation a deduction generally equal to 37.5% (21.875% for tax years beginning after 2025) of FDII, reduced to the extent that other deductions would otherwise effectively reduce the corporation's taxable FDII Determines a domestic corporation's FDII using a complex formula, with FDII loosely correlating with the domestic corporation's net income earned through US operations in connection with "export" sales, leases, licenses and services, to the extent exceeding a "deemed tangible return" amount calculated with reference to the basis in depreciable tangible property used in those US operations
Effective date	Effective for tax years beginning after 31 December 2017
Implications/ key takeaway	May create, when coupled with the new GILTI and BEAT regimes, a significant incentive to "onshore" certain operations and assets into the US

Resources

See a detailed description of this provision

Tax Alert 2017-2166

Joint Explanatory Statement p.494

Legislative text (H.R. 1-160)

Webcast: International tax changes under tax reform

Base erosion and anti-abuse tax (BEAT) (IRC Section 59A)

Prior law	Did not include any similar provision
New law	Imposes a new base erosion minimum tax, BEAT, on corporations (other than registered investment companies (RICs), real estate investment trusts (REITs) or S corporations) subject to US net income tax that: (i) have average annual gross receipts of at least \$500 million; and (ii) have made related-party deductible payments totaling 3% (2% for banks and certain security dealers) or more of the corporation's total deductions for the year Defines base erosion minimum tax amount as equal to 5% of modified taxable income (i.e., taxable income determined without regard to base erosion tax benefits) in excess of regular tax liability, taking into account certain credits Increases 5% rate for tax years beginning in calendar year 2018 to 10% after the first year, and to 12.5% for years beginning after 31 December 2025 Applies increased rates of 6%, 11% and 13.5% respectively, for members of an affiliated group that includes a bank or registered securities dealer
Effective date	Effective for base erosion payments paid or accrued after 31 December 2017
Implications/ key takeaways	Aims to capture a broad category of base-eroding payments by corporate taxpayers of large affiliated groups to foreign related persons while generally excluding costs of goods sold (COGS) and providing certain exceptions Can effectively deny, in part or entirely, the benefit of tax credits, because BEAT is a minimum tax that is compared to the regular tax liability after most tax credits

Resources

See a detailed description of this provision

Tax Alert 2017-2166

Joint Explanatory Statement p.524

Legislative text (H.R. 1-173)

Webcast: International tax changes under tax reform

Denial of deduction for certain hybrid payments (IRC Section 267A)

Prior law	▸ Did not include any similar provision
New law	▸ Denies a deduction for any "disqualified related-party amount" paid or accrued under a hybrid transaction (involving payments that are treated as interest or royalties for US tax purposes but not by the recipient's residence country) ▸ Denies a deduction for any "disqualified related-party amount" paid or accrued by, or to, a hybrid entity (an entity that is fiscally transparent for US tax purposes but not for purposes of the tax law of the resident country, or vice versa)
Effective date	▸ Effective for tax years beginning after 31 December 2017
Implications/ key takeaways	▸ Targets "hybrid mismatch" situations in which there is a deduction in the US for certain foreign related-party payments but no income inclusion in the foreign country ▸ Grants Treasury broad authority to issue regulations covering specific issues, which could significantly expand the provision's scope ▸ Implements, in general, Organisation for Economic Co-operation and Development (OECD) recommendations on hybrid mismatches

Resources

See a detailed description of this provision

Tax Alert 2017-2166

Joint Explanatory Statement p.537

Legislative text (H.R. 1-166)

Webcast: International tax changes under tax reform

Other adjusted provisions

CFC sale or transfer

Includes in subpart F income the foreign-source portion of gain that is treated as a dividend under Section 964(e)(1) upon an upper-tier CFC's sale of a lower-tier CFC, but entitles the US shareholder to a 100% deduction

Loss limitations for 10%-owned foreign corporation

Reduces adjusted basis in stock by amount of any 100% deductions claimed with respect to dividends on such stock, solely for purposes of determining loss on disposition of stock of a 10%-owned foreign corporation

Inventory sourcing rules

Requires source of income from certain "cross-border" sales of inventory to be determined solely on the basis of the production activities with respect to the inventory

Overall domestic losses (ODLs)

Allows for an election to recapture more than 50% (but not above 100%) of an ODL balance as foreign-source earnings for purposes of a pre-2018 ODL balance

FMV method of interest expense apportionment

Prohibits US-affiliated groups from apportioning interest expense on the basis of the fair market value of assets, thereby requiring use of adjusted tax basis of assets

Separate basket for foreign branches

Creates new Section 904(d) category for "foreign branch income" that is not a passive category income

Other adjusted provisions (cont.)

US shareholder definition

Extends the Section 951(b) definition of US shareholder to include US persons that own 10% or more of the voting power or value of a foreign corporation

Amended Section 960 credit

Amends Section 960 to deem a US corporation that has a subpart F inclusion with respect to a CFC as paying only the CFC's foreign income taxes "properly attributable" to such item of income

Intangible property transfers

Amends the definition of intangible property in Section 936(h)(3)(B) to include workforce in place, goodwill (foreign and domestic) and going concern value

Surrogate foreign corporations

Makes dividends from any corporation that becomes a surrogate foreign corporation after date of enactment ineligible for the "qualified dividend income" favorable tax rate

Insurance PFIC exception

Restricts the PFIC exception for insurance companies to require, in part, that the company's applicable insurance liabilities constitute greater than 25% of total assets

Excise tax on inversion stock

Increases the rate of excise tax on stock compensation held by insiders of an expatriated corporation from 15% to 20% for corporations first becoming expatriated after 22 December 2017

Significant retained provisions

FBCI de minimis exception

Retains $1 million de minimis amount for foreign base company income (FBCI)

CFC look-through rules

Retains current law under Section 954(c)(6) so the look-through rule for related CFCs applies only to tax years of a CFC beginning before 1 January 2020

Allocation of interest

Retains current law under which worldwide interest allocation rules would apply to tax years beginning after 31 December 2020

Investment of earnings in US property

Retains Section 956 (investment of earnings in US property) for domestic corporations that are US shareholders in a CFC

Significant repealed provisions

CFC stock attribution rules

Repeals Section 958(b)(4), so downward attribution may apply to treat stock owned by a foreign person as constructively owned by US persons owned by that foreign person

Indirect foreign tax credit

Repeals the deemed-paid credit with respect to dividends received by a domestic corporation that owns 10% or more of the voting stock of a foreign corporation

Qualified investment income

Repeals Section 955, which required pro rata inclusion of previously excluded subpart F income when a CFC decreased its investment in qualified foreign base company shipping operations

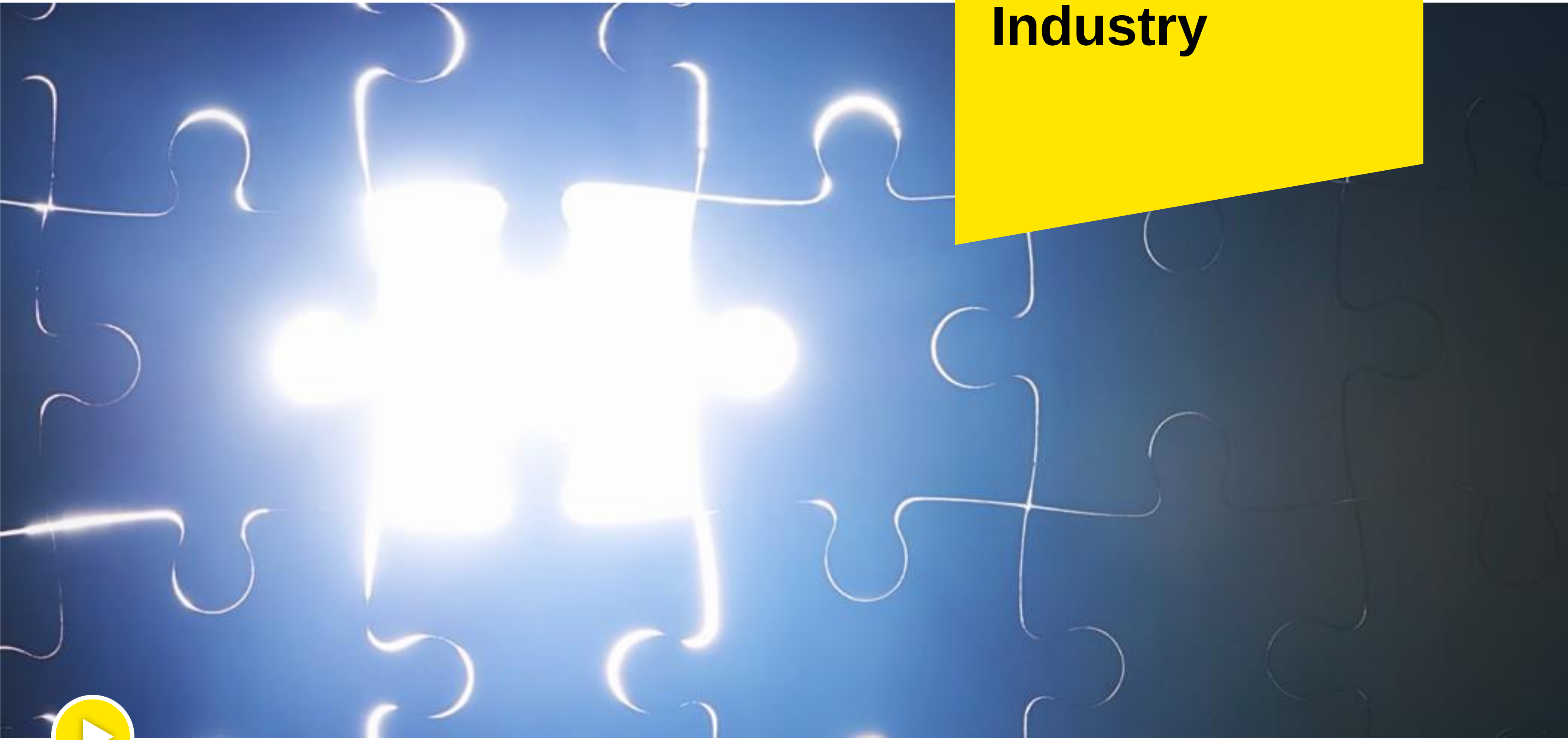
Foreign oil-related income

Repeals provision that treats foreign base company oil-related income as a category of subpart F income

30-day CFC rules

Repeals requirement that a corporation must be a CFC for an uninterrupted period of 30 days during the tax year before subpart F inclusions apply

Industry



The Tax Cuts and Jobs Act

Tax Guide

Industry overview

How to use this section

This section of the Tax Guide highlights some of the Act's implications for various industries. To access a particular industry, click on one of the links in the resource box to the right or scroll through the slides in this section.

The headings on each slide in this section link to a slide in the Corporate/Business or International section, so users can easily access an overview of the provision whose implications are discussed.

The implications discussed on each slide are not comprehensive. For a comprehensive discussion of the provisions affecting each industry, click on Tax Alert links in the resource box on each slide.

Resources

- Consumer products and retail
- Energy
  - Mining and minerals
  - Oil and gas
  - Power and utilities
- Financial services
  - Private equity and hedge funds
  - Regulated investment companies
- Insurance
- Life sciences
- Media & entertainment
- Real estate
- Technology
- Telecommunications

Corporate/business implications

Corporate rate

- Lowers the marginal tax rate for the industry, which previously did not benefit from various preference items available to other industries
- Results in a blended rate under existing Section 15 for fiscal year-end consumer products and retail companies

Interest limitation

- Increases the economic cost of a debt-financed acquisition, thereby reducing the advantage of financing merger and acquisition transactions with debt
- Incentivizes consumer products companies and retailers facing deferral or disallowance of interest deductions to increase their net interest income, either by converting interest into another type of deductible expense or by converting another type of income into effectively tax-free interest income
- May subject highly leveraged companies to Section 382 solely because they have disallowed interest

NOLs

- Negatively affects the industry, which previously relied on specified liability losses as a source of cash-tax savings

Real property cost recovery

- Benefits the industry by streamlining the treatment of certain real property into a single “qualified improvement property” definition, which is subject to less onerous requirements than the prior definition of qualified leasehold improvement property
- Consider how leased property will be affected by the Act's classification of qualified improvement property as property with a 39-year recovery period, which is ineligible for bonus depreciation

Resources

Tax Alert 2017-2201

Tax Alert 2018-0012

Tax Alert 2018-0394

International implications

GILTI

- Affects consumer products companies and retailers with high-value intangibles or high-margin service companies in their supply chains that do not have significant QBAI, such as foreign procurement hubs, intellectual property (IP) companies or principal operating companies, as intangible property is not taken into account in calculating QBAI
- Results in GILTI even when income is subject to a relatively high rate of foreign tax, due to allocations of expenses, such as interest expense, against income in computing the foreign tax credit limitation

FDII

- Incentivizes US consumer products companies and retailers to sell products or services, or to license intangibles (e.g. brands) to parties outside the United States
- Benefits US consumer products companies and retailers licensing IP to foreign parties
- Precludes "round-tripping" by requiring sales of goods, services or IP to foreign related parties to be for foreign use

BEAT

- Affects US consumer products companies and retailers licensing brands or other IP from foreign related parties
- Should not affect US companies purchasing goods via a foreign related procurement company if the goods are: 1) purchased from the foreign procurement company; or 2), the commission or service fee paid to the foreign procurement company is inventoriable under Section 263A
- Evaluate whether services payments to foreign companies qualify under the service-cost method and are therefore not subject to the BEAT

Resources

Tax Alert 2017-2201

Corporate/business implications

Mining and minerals

AMT

- Allows mining companies whose AMT status previously precluded claims for percentage depletion to claim the deduction
- Could prompt reevaluation of the benefits of flow-through versus corporate ownership of mining interests, as individuals who own interests in mines through a partnership or S corporation will still be subject to AMT and may be ineligible to claim percentage depletion

Qualified property expensing

- May adversely affect a company's ability to claim percentage depletion
- Consider the use of structures such as captive leasing companies , which enable companies to currently benefit from bonus depreciation, while smoothing the depreciation expenditures over the useful life of the asset

Percentage depletion

- Explore opportunities to claim the full amount of allowable percentage depletion deductions now that AMT no longer precludes those claims
- Explore how modifications to pre-tax-reform percentage depletion calculations could increase value by creating additional AMT tax credits, which will now be refundable

Resources

Tax Alert 2017-2178

Tax Alert 2017-2222

Tax Alert 2018-0092

Tax Alert 2018-0186

Webcast: Impact of US tax reform on the energy industry

Corporate/business implications (cont.)

Oil and gas

Corporate rate

- Lowers income tax liabilities for oil and gas companies, especially when combined with deductions for intangible drilling and development costs, geological and geophysical costs, and percentage depletion (when applicable), which were retained under the Act

AMT

- Benefits corporate oil and gas companies with carryover AMT credits
- Could prompt reevaluation of the benefits of flow-through versus corporate ownership of oil and gas interests, as individuals who invest in oil and gas companies through a partnership or S corporation will still be subject to AMT and may be ineligible for certain cost recovery provisions like percentage depletion
- Evaluate the balance sheet classification of AMT credit carryforwards after 22 December 2017

Qualified property expensing

- May provide an immediate cash-tax benefit by reducing the recovery time for capital investments, and allows wider base of assets to qualify for 100% expensing due to relaxation of the "original use" rules
- Provides relative certainty for short- and long-term planning while encouraging capital investments

Interest limitation

- May lower interest expense deductions for oil and gas companies in years beginning in 2022
- Incentivizes oil and gas companies facing deferral or disallowance of interest deductions to increase their net interest income, either by converting interest into another type of deductible expense or by converting another type of income into effectively tax-free interest income

Resources

Tax Alert 2017-2178

Tax Alert 2017-2222

Tax Alert 2018-0092

Tax Alert 2018-0186

EYU *Webcast: Impact of US tax reform on the energy industry*

Corporate/business implications (cont.)

Power and utilities

Corporate rate

- Results in excess accumulated deferred tax balances that need to be passed on to customers in accordance with current normalization rules
- Raises questions about the treatment of changes in deferred tax balances other than accelerated depreciation under Sections 167 and 168 that have no mandated treatment, such as benefit plans, bad debts, NOLs, repairs and derivatives, among other items
- Determine how to handle the reduction in tax rates for years before the next rate case

Qualified property expensing

- Eliminates bonus depreciation for utility property acquired and placed in service after 27 September 2017
- Creates uncertainty about the treatment of property purchased after 27 September 2017 by entities regulated by the Federal Energy Regulatory Commission

Interest limitation

- Excludes utilities from the definition of a trade or business subject to the interest limitation
- Creates uncertainty on what “properly allocable” means in the context of the interest exclusion for consolidated groups that include regulated operations as well as non-regulated or holding companies

Contributions in aid of construction

- Redefines Section 118 (b) to include contributions from customers as well as any payment received from a governmental or civic entity
- Repeals the exclusion from gross income under Section 118(c) for water utilities

Resources

Tax Alert 2017-2178

Tax Alert 2017-2222

Tax Alert 2018-0092

Tax Alert 2018-0186

Webcast: Impact of US tax reform on the energy industry

International implications

All industries

Transition tax, GILTI, FDII, BEAT

- Incentivizes multinational companies to evaluate capital structure, holding company structure, logistics and supply chain, and contracts

Resources

Tax Alert 2017-2178

Tax Alert 2017-2222

Tax Alert 2018-0092

Tax Alert 2018-0186

Webcast: Impact of US tax reform on the energy industry

Limitation on deduction for FDIC premiums (IRC Section 162(r))

Prior law	Allowed banks to deduct semiannual assessments paid into the deposit insurance fund to maintain status as an insured depository institution as ordinary and necessary business expenses once the all-events test was satisfied
New law	Limits deductions for FDIC premiums paid by certain institutions with total consolidated assets of $10-$50 billion Completely disallows deductions for institutions whose total consolidated assets exceed $50 billion
Effective date	Effective for tax years beginning after 2017
Implications/ key takeaway	Increases income tax liabilities for affected banks

Resources

See a detailed description of this provision

Tax Alert 2017-2130

Joint Explanatory Statement p.254

Legislative text (H.R. 1-100)

Webcast: US tax reform impacts on the banking and capital markets industry

Corporate/business implications

Private equity and hedge funds

Corporate rate

- Should increase free cash flow, particularly when combined with immediate expensing
- Should mitigate the effects of limits on interest deductibility
- May result in cash-tax savings

NOLs

- Could affect the tax shield of certain PE portfolio company investments

Special rules for tax year of inclusion

- Appears less likely to require acceleration of fee and incentive payments
- Does not address application to funds that hold market discount and other debt securities
- Does not apply to investment income from a PE fund that is treated as an investor and not engaged in a trade or business

Pass-through deduction

- May apply to:
  - Limited types of non-investment income earned by a trader fund, provided the wage or capital thresholds are met
  - Income allocated from underlying portfolio funds to upper-tier fund of funds
  - Operating pass-through income that tiers up through a fund structure
  - Income allocated to a general partnership
  - Certain income allocated to an individual partner of a publicly traded partnership that is taxable as a partnership because it qualifies for the passive income exception of Section 7704(c)
- Likely does not apply to income from management services
- Does not apply to investment income from a PE fund that is treated as an investor and not engaged in a trade or business
- Does not generally apply to investment income

Resources

Tax Alert 2017-2193

Tax Alert 2017-2230

Tax Alert 2018-0085

Corporate/business implications (cont.)

Private equity and hedge funds (cont.)

Carried interest

- Will have varying effects, depending on a fund's trading style and typical holding period
- Should prompt affected fund managers to analyze how the change will apply to funds and fee structures, as well as the way in which the managers hold residual interests in the fund

Business loss limitation

- Could affect management companies that run at a taxable loss
- Does not clearly address how to treat distributable share from a "trader" fund
- Should prompt fund managers and investors to consider the potential effects on their structures

Sale of partnership interests by foreign partners

- May affect pass-through investments at the portfolio-company, fund and limited-partner level (including for fund-of-fund investors) and for certain management company sale transactions
- May affect taxpayers considering filing refund claims for open tax years before 2017

Limitation on excessive employee remuneration

- Could affect portfolio company management teams

Resources

Tax Alert 2017-2193

Tax Alert 2017-2230

Tax Alert 2018-0085

Corporate/business implications (cont.)

Regulated investment companies

Interest limitation

- May affect business development companies (BDCs) and some closed-end RICs unless their interest income from debt instruments exceeds their interest expense
- Does not specify whether BDCs and RICs are engaged in a business for purposes of the limitation
- Is not clear if "adjusted taxable income" must be reduced by dividends-paid deduction

Special rules for tax year of inclusion

- May only require immediate inclusion of some types of loan-related and credit-card-related fee income, but could be far broader
- May require accelerated inclusion of income on instruments that are classified as debt for GAAP purposes and equity for tax purposes, such as some types of preferred stock

Pass-through deduction

- Does not apply to RICs because they are corporations
- Appears to preclude RICs from passing the deduction to non-corporate shareholders

Resources

Tax Alert 2017-2193

Tax Alert 2017-2230

Tax Alert 2018-0085

International implications

Private equity and hedge funds

Transition tax, GILTI, and BEAT

- Consider the possible effects of the one-time transition tax on fund reporting
- Consider whether certain portfolio companies could become subject to anti-deferral or anti-base erosion measures

Regulated investment companies

Dividends received from foreign subsidiaries

- Prohibits RICs and REITs from claiming the 100% exemption for certain foreign-source dividends

Transition tax

- May apply to RICs that own 10% or more of a specified 10% foreign-owned corporation or CFC in that foreign corporation's final tax year beginning before 1 January 2018
- Does not affect the tax treatment of a RIC's wholly owned investment subsidiaries, as RICs already include subpart F income from these subsidiaries on a current basis

GILTI

- May affect RICs that are 10%-or-greater shareholders of CFCs
- Does not affect the tax treatment of a RIC's wholly owned investment subsidiaries, as RICs already include subpart F income from these subsidiaries on a current basis
- Denies RICs the 50% exclusion for GILTI income that is available to most US corporations

Insurance PFIC exception

- Requires RICs to modify their PFIC-identification procedures

Resources

Tax Alert 2017-2193

Tax Alert 2017-2230

Tax Alert 2018-0085

Computation of life insurance tax reserves (IRC Section 807(d))

Prior law	▸ Limited an insurer's life insurance reserve included in the computation of taxable income to the greater of a contract's net surrender value (NSV) or an amount determined by applying a complicated formula, capped at the contract reserve reported on insurer's regulatory annual statement (statutory reserve)
New law	▸ Discards the complicated formula and specifies that the life insurance reserve included in the computation of taxable income is the greater of: (1) a contract's NSV; or (2) an amount that is 92.81% of the tax reserve method applicable to the contract, capped at the statutory reserve ▸ Uses a different formula for a separate account variable contract, still capped at the statutory reserve reported, which is the greater of: (1) the contract's NSV; or (2) the portion of the reserve separately accounted for under Section 817, plus the excess, if any, of the tax reserve computed using the tax reserve method applicable to the contract over; (ii) the contract's NSV
Effective date	▸ Effective for tax years beginning after 2017, with a transition rule requiring any difference between the amount of the reserve held as of 31 December 2017 and the reserve that would have been held had the new law been in effect in 2017, to be taken into account ratably over eight years beginning in 2018
Implications/ Key takeway	▸ Simplifies the calculation of deductible tax reserves and helps reduce uncertainty about the treatment of new reserving methodologies ▸ Appears to build elasticity into the computation of tax-deductible reserves to accommodate new reserving methodologies ▸ Reduces administrative complications associated with implementing principles-based reserves

Resources

[See a detailed description of this provision](#)

[Tax Alert 2018-0027](#)

[Joint Explanatory Statement p.330](#)

[Legislative text (H.R. 1-91)](#)

[Webcast: Impact of US tax reform on the captive insurance market](#)

Capitalization of certain policy acquisition expenses (IRC Section 848)

Prior law

- Required insurance companies to capitalize and amortize “specified policy acquisition expenses” for any tax year over the 120-month period beginning with the first month in the second half of the tax year in which such expenses are incurred
- Determined “specified policy acquisition expenses” by applying specified percentages (deferred acquisition cost (DAC) rates) to the insurer’s net premiums for certain types of insurance contracts

New law

- Increases the 120-month amortization period to 180 months and the DAC rates used to compute “specified policy acquisition expenses”

Effective date

- Effective for tax years beginning after 2017

Implications/ Key takeaway

- Significantly increases the life insurance industry’s taxable income, but represents a compromise over prior proposals to revise the provision
- Changes only the length of the amortization period and the DAC rates under the Section 848 DAC rules, so the application of the rest of Section 848 and its accompanying regulations should not change

Resources

See a detailed description of this provision

Tax Alert 2018-0027

Joint Explanatory Statement p.336

Legislative text (H.R. 1-95)

Webcast: Impact of US tax reform on the captive insurance market

Adjustment for change in computing life insurance reserves (IRC Section 807(f))

Prior law	Allowed a special 10-year period for adjustments to take into account changes in computing life insurance reserves
New law	Takes income or loss resulting from a change in method of computing life insurance reserves into account, consistent with IRS change of accounting method procedures, instead of 10 years under prior law
Effective date	Effective for tax years beginning after 2017
Implications/ key takeaway	Raises several questions about what constitutes a change in basis when computing life insurance reserves under the new rules based upon NAIC tax reserve methodology

Resources

Tax Alert 2018-0027

Joint Explanatory Statement p.320

Legislative text (H.R. 1-90)

Webcast: Impact of US tax reform on the captive insurance market

Other adjusted provisions

Life insurance proration

Limits company share of DRD to 70% and policyholder share to 30%

Life insurance contracts

Effective for tax years beginning after 2017, imposes a reporting requirement on both the acquirer of an interest in an existing life insurance contract and the payor of death benefits if the acquirer had no substantial family, business, or financial relationship with the insured before acquiring the life insurance contract

P&C proration rules

Replaces 15% reduction in the reserve deduction for property & casualty (P&C) insurance companies with 25%, starting in 2018

P&C discounting rules

Modifies discounting rules for P&C insurance companies to take into account an interest rate based upon a corporate bond yield curve and extends the length of the discount period for long-tailed reserves from 16 years to 25 years

Significant repealed provisions

Special estimated tax

Repeals, for tax years beginning after 2017, the elective deduction for insurance companies equal to the difference between the amount of reserves computed on a discounted and undiscounted basis and the corresponding special estimated tax payment

Small life insurance company deduction

Repeals small life insurance company deduction of 60% of first $3 million of life insurance-related income for companies with assets below $500 million

Pre-1984 surplus account

Repeals Section 815, subjecting life insurers in existence before 1984 to tax on "Phase III" income; requires any remaining "Phase III" balance as of 31 December 2017, to be included in taxable income ratably over eight years

Corporate/business implications

Computation of life insurance tax reserves

- Consider modifying life tax reserving systems to incorporate tax law changes
- Consider product repricing and potentially redesigning/developing life insurance products
- Review the "tax reserve method" definition carefully to be certain it provides the same reserve computed for NAIC annual statement purposes
- Consider calculating a separate tax reserve to the extent there are differences between the two definitions

Life insurance proration

- Significantly simplifies Section 812
- May disadvantage certain insurance companies based on their mix of business and investment approach

Resources

Tax Alert 2018-0027

Corporate/business implications (cont.)

Corporate rate

- May result in a lower effective tax rate for the insurance industry, but a higher current tax expense for individual insurance companies due to insurance-specific base broadeners

Interest limitation

- Unlikely to affect insurance companies significantly due to ability to net interest income and expense

NOLs

- Raises significant statutory accounting issues for life insurers
- May lessen profitability on existing life insurance policies whose pricing was based on the ability to carry back NOLs
- Requires life insurers to assess how to price contracts going forward with regard to the taxation of losses and whether to include any assumptions in pricing
- Does not apply to P&C insurance companies

Special rules for tax year of inclusion

- Raises questions about whether insurers may still defer the accrual of market discount
- Does not specify whether the applicable financial statement is the NAIC annual statement for all insurers

Resources

Tax Alert 2018-0027

International implications

Transition tax

- Will likely subject foreign insurance subsidiaries to a higher rate of tax on un-repatriated earnings to the extent their earnings are held in cash or securities used to support insurance reserves

GILTI

- Could affect insurance company CFCs that meet the active financing exception (AFE) rules because the new law lacks a carve-out for AFE qualifying income

BEAT

- Could significantly affect companies with significant related-party cross-border insurance and reinsurance transactions

Resources

Tax Alert 2018-0027

Corporate/business implications

Corporate rate

- Identify opportunities to accelerate deductions and defer income, such as:
  - Accelerating deductions for charge-backs paid to third-party wholesalers under the recurring item exception
  - Filing a non-automatic method change to accelerate deductions for product returns when received, but not yet paid, under the recurring item exception
  - Filing a non-automatic method change to defer recognition of revenue of receivables in dispute (e.g., due to incorrect product quantities/goods, invoice pricing errors, etc.) under general revenue recognition principles of Section 451
  - Using the deferral method of Revenue Procedure 2004-34 to the extent payments are recognized for financial statement purposes for a tax year following the tax year of receipt

Domestic production deduction

- Focus on Section 199 planning for tax years beginning before 1 January 2018 to ensure the benefit is maximized before the year of repeal
- Update Section 199 computations to reflect software transformations and digital initiatives
- Review existing Section 199 claims for opportunities to claim additional deductions on amended returns
- Consider making an initial Section 199 claim on an amended return for open tax years beginning before 1 January 2018

Orphan drug credit

- Claim, if possible, the modified orphan drug over the alternative simplified credit under Section 41(c)(5), as the alternative simplified credit provides a 14% credit while the orphan drug credit is 25%

Resources

Tax Alert 2017-2170

International implications

GILTI

- May result in life sciences companies having significant amounts of GILTI due to:
  - Exclusion of intangible property from QBAI
  - Significant amount of offshore intangible property held by life sciences companies
  - Lack of high-basis tangible assets as a result of outsourcing of manufacturing, the age of existing manufacturing facilities or other supply chain changes

Deduction for FDII and GILTI

- May be of particular interest to companies in the life science industry that own the US intangible rights and the related functions already in the US

BEAT

- Affects life science companies that have complex and global supply chains with many cross-border payments for goods, services and IP

Intangible property transfers

- Affects life sciences companies that license or sell intangibles to be used abroad

Resources

Tax Alert 2017-2170

Corporate/business implications

Qualified property expensing

- Consider using the income forecast depreciation method for "stub" period properties because it is accelerated, and permits a write-off in the year there is no future income
- Reevaluate all scheduled foreign production and consider whether it should be moved to the United States to take advantage of bonus depreciation
- Capitalize development costs and recover them through bonus depreciation when the property is acquired and placed in service or, if no production occurs, under Revenue Procedure 2004-34
- Apply bonus depreciation carefully, as the Section 181 rules for qualified property will limit the films and television programming to which bonus depreciation applies

Interest limitation

- Increases the economic cost of a debt-financed acquisition, thereby reducing the advantage of financing merger and acquisition transactions with debt
- Incentivizes media and entertainment (M&E) companies facing deferral or disallowance of interest deductions to increase their net interest income, either by converting interest into another type of deductible expense or by converting another type of income into effectively tax-free interest income

Amortization of R&E expenditures

- Eliminates expensing of software development, which M&E companies have historically expensed under Revenue Procedure 2000-50, and requires that cost to be capitalized and amortized over five years, beginning in tax years after 31 December 2021

Resources

Tax Alert 2017-2202

Tax Alert 2018-0106

International implications

Transition tax

- Permits media companies with E&P deficits in foreign ownership chains to continue offsetting those deficits against positive earnings for transition tax purposes
- Determine transition tax liability by:
  - Reviewing historic E&P and tax pools
  - Determining cash and cash equivalent balances to be included as of the relevant dates
  - Assessing foreign tax credit utilization positions (including overall foreign losses), and the availability of attributes (e.g., existing or carryforward foreign tax credits, NOLs or other credits) to offset transition tax liabilities

GILTI and FDII

- Analyze the GILTI implications of international legal structures and operating models going forward
- Determine eligibility for 13.1% rate on future foreign intangible income, regardless of IP ownership in the United States or offshore
- Focus on managing the effective rate on future FDII and GILTI income, as well as the local country tax rate on international operations
- Base IP investment and centralization strategies on commercial, legal, human resource and other business considerations, as well as the availability of tax attributes in the United States and locally to support future US or foreign hub models
- Consider the tax costs of bringing offshore IP to the United States

Resources

Tax Alert 2017-2202

Tax Alert 2018-0106

International implications (cont.)

BEAT

- Examine supply chain models for potential BEAT exposures, regardless of whether they are US or offshore hub structures
- Identify planning opportunities around re-designing supply chain flows and contracting models, as well as the business purpose behind potential future restructuring

Denial of deduction for certain hybrid payments

- Consider the potential applicability of these hybrid rules on financing and/or IP structures
- Evaluate alternative options from a planning perspective if required

Resources

Tax Alert 2017-2202

Tax Alert 2018-0106

Corporate/business implications

Corporate rate

- Reassess whether existing structures will continue to provide the most advantageous results in the context of their projected business needs and activities

Interest limitation

- Allows eligible real property trades or businesses to elect out of the limitation on the deductibility of interest expense, but requires depreciation of nonresidential real property, residential real property, and qualified improvement property under the alternative depreciation system
- May be difficult for certain companies to determine whether they qualify as a real property trade or business

Pass-through deduction

- Appears to apply to ordinary income from rental real estate
- Limited in most cases by a formula that considers wages paid and/or the unadjusted basis of property used in the qualified trade or business
- Applies to certain dividends received from REITs and income allocations from certain master limited partnerships

Carried interest

- Represents an improvement over prior legislative proposals, but raises questions such as:
  - How does the rule apply when the gain potentially subject to the provision is characterized as long-term capital gain without an express reference to Section 1222 (i.e., Section 1231 gains and REIT capital gain dividends)?
  - How does the rule apply when the partnership interest and the asset giving rise to the gain have different holding periods?

Like-kind exchanges

- Take care to understand the nature of the property being exchanged, as personal property is not eligible for tax-free exchange treatment

Resources

The Tax Cuts and Jobs Act: Implications for the real estate industry

Corporate/business implications

Interest limitation

- Negatively affects:
  - Highly leveraged technology companies
  - Technology companies that traditionally consider the deduction of interest expense to be an important factor in their operating business decisions
  - Inbound and outbound technology companies

Domestic production deduction

- May negatively affect technology companies in post-2018 tax years that benefited from the deduction, but new incentives, such as the lower overall 21% corporate tax rate, the immediate expensing of qualified property to the extent available, and the FDII, may offset those effects
- Model the overall effect of losing the deduction and gaining the new incentives
- Examine opportunities for look-back Section 199 studies for open tax years

Amortization of R&E expenditures

- Represents more of a cash flow and timing issue than loss of benefit, so technology companies will eventually be in the same place as they would have been under prior law, but over an extended period (5 or 15 years).

Limitation on excessive employee remuneration

- Review equity compensation plans to identify potential changes that may affect employees

Resources

Tax Alert 2017-2200

International implications

Dividends received from foreign subsidiaries

- Benefits technology companies that generate significant earnings and profits overseas but the benefit may be offset by the requirement to pick up GILTI income (see discussion on GILTI)
- Continue to monitor and manage existing Subpart F and other anti-deferral provisions such as effectively connected income (ECI) within supply chains
- Evaluate the effects of the new GILTI provision aimed at taxing foreign intangible returns, including the impact of foreign tangible asset investments
- Closely monitor the foreign tax profile as Section 902 is generally repealed and Section 901 excludes dividend withholding taxes
- Assess the relevant tax accounting positions for potential GILTI income in future years

Transition tax

- Negatively affects technology companies with significant untaxed earning and profits
- Review earnings and profits/tax pools to confirm they are up-to-date and accurate
- Review balance sheets to sort out and identify the cash and non-cash assets
- Review availability of tax attributes (e.g., foreign tax credit carryforwards and NOLs) that may reduce transition tax
- Model the effects of the transition tax and evaluate options (e.g., elect to pay transition tax through installments, elect to forego use of NOLs to offset transition taxable income, etc.)

GILTI

- Lessens the benefits of a territorial system for most technology companies that are intangible-property intensive, as the 10% minimum US tax applies to the bulk of their foreign earnings
- Evaluate IP alignment strategies incorporating both the GILTI and FDII provisions
- Limits the ability to utilize foreign taxes paid because GILTI is treated as a separate basket and GILTI basket taxes are subject to a 20% haircut

Resources

Tax Alert 2017-2200

International implications (cont.)

Deduction for FDII and GILTI

- May benefit technology companies that choose to retain intangible property in the US, but results of alternative scenarios should be modelled, taking into account both the FDII and GILTI provisions, respectively
- Evaluate the impact of the revised transfer pricing rules on any IP alignment strategies under consideration

BEAT

- Provides flexibility for technology companies whose supply chain requires them to purchase goods or services (e.g., R&D) from overseas related parties
- Evaluate supply chains to determine possible BEAT impact

Denial of deduction for certain hybrid payments

- Evaluate supply chains to identify potential hybrid arrangements and any negative effects (e.g., loss of a deduction related to a hybrid arrangement) under the GILTI provisions

Resources

Tax Alert 2017-2200

Corporate/business implications

Qualified property expensing

- Provides eligible telecom operators with an immediate cash-tax benefit, which could be used to develop network infrastructure
- Applies to telecom network assets defined within Revenue Procedure 87-56, such as:
  - Central Office Buildings
  - Central Office Equipment
  - Fiber optic and copper cabling, poles and related land improvements

Domestic production deduction

- Consider claiming the Section 199 deduction for current–year production or service activities
- Review prior-year claims and, where warranted, file amended returns.

Amortization of R&E expenditures

- Negatively affects telecom companies that previously expensed R&E costs
- Negatively affects telecom companies with significant foreign research by providing a longer recovery period for foreign research, presumably to incentivize domestic research.
- Places telecom companies that develop their own software in a worse tax position than those acquiring software by treating software development as an R&E expense that must be capitalized and amortized, rather than currently expensed under Revenue Procedure 2000-50

Resources

Tax Alert 2018-0063

Corporate/business implications (cont.)

Research credit

- Consider projects that could qualify for the research credit, including projects focused on:
  - Improvement of network performance
  - Development of software to allow for new and improved functional integration or the provision of required services
  - Bandwidth modeling projects
  - Data traffic measurement
  - Design of custom communication networks for specific uses and layouts
  - Testing of next generation network and capabilities

Resources

Tax Alert 2018-0063

International implications

GILTI and FDII

- Consider the GILTI implications of international legal structures and operating models going forward
- Determine eligibility for 13.1% rate on future foreign intangible income, regardless of IP ownership in the United States or offshore
- Focus on managing the effective rate on future FDII and GILTI income, as well as the local country tax rate on international operations

Resources

Tax Alert 2018-0063

Individual provisions

The Tax Cuts and Jobs Act

Tax Guide

Individual tax rates (IRC Section 1)

Prior rates

Rate	Married filing jointly (MFJ)	Head of Household (HoH)	Single	Estate and trust
10%	<$18.650	<$13,350	<$9,325	N/A
15%	<$75,900	<$50,800	<$37,950	<$2,550
25%	<$153,100	<$131,200	<$91,900	<$9,150
28%	<$233,350	<$212,500	<$191,650	N/A
33%	<$416,700	<$416,700	<$416,700	N/A
35%	<$470,700	<$444,500	<$418,400	<$12,500
39.6%	>$470,700	>$444,500	>$418,400	>$12,500

New rates

Rate	MFJ	HoH	Single	Estate and trust
10%	<$19,050	<$13,600	<$9,525	<$9,525
12%	<$77,400	<$51,800	<$38,700	<$38,700
22%	<$165,000	<$82,500	<$82,500	<$82,500
24%	<$315,000	<$157,500	<$157,500	<$157,500
32%	<$400,000	<$200,000	<$200,000	<$200,000
35%	<$600,000	<$500,000	<$500,000	<$300,000
37%	>$600,000	>$500,000	>$500,000	>$300,000

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.2

Legislative text (H.R. 1-1)

Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform

Individual tax rates (IRC Section 1) (cont.)

Effective date	‣	Effective for tax years beginning after 2017 and before 2026
Implications/ key takeaway	‣	Retains seven tax brackets but lowers the rate for most brackets

Resources

[See a detailed description of this provision](#)

[Tax Alert 2017-2168](#)

[Joint Explanatory Statement p.2](#)

[Legislative text (H.R. 1-1)](#)

[Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform](#)

Alternative inflation adjustment (IRC Section 1(f)(3))

Prior law

- Adjusted individual income tax amounts (e.g., regular income tax brackets, basic standard deduction) for inflation based on annual changes in the level of the Consumer Price Index for All Urban Consumers (CPI-U), which measures prices paid by typical urban consumers on a broad range of products

New law

- Requires inflation adjustments to be based on the Chained Consumer Price Index for All Urban Consumers (Chained CPI-U), rather than on the CPI-U

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway

- Results in indexed amounts rising more slowly than they would under CPI-U
- May increase income tax burden for individuals living in urban areas

Resources

Tax Alert 2017-2168

Joint Explanatory Statement p.17

Legislative text (H.R. 1-6)

Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform

Individual AMT (IRC Section 55)

Prior law

- Subjected to the AMT certain individuals with special circumstances, allowing for lower payments of standard income tax

New law

- Increases exemption from AMT: $109,400 (joint filers), $70,300 (single); phase-out threshold increases to $1 million for joint filers and $500,000 for all other taxpayers, except trusts and estates

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway

- May make it less likely that noncorporate taxpayers owe AMT, but individual taxpayers will still need to compute it (partnerships and S corporations will need to compute AMT preferences for use in individual AMT computations), which will continue to add complexity to their returns

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.145

Legislative text (H.R. 1-42)

Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform

Standard deduction (IRC Section 63(c))

Prior law
- Allowed standard deduction of $6,350 for single filers; $12,700 for married filing jointly; $9,350 for head of household

New law
- Increases the standard deduction (indexed for inflation): $12,000 for single filers; $24,000 for joint filers; and $18,000 for head of household

Effective date
- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway
- Should simplify federal income tax filings for many taxpayers through 2025

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.14

Legislative text (H.R. 1-19)

Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform

Child tax credit (CTC) (IRC Section 24)

Prior law

- Allowed an individual to claim a $1,000 tax credit for each qualifying child, with the credit phased out as adjusted gross income (AGI) exceeded certain thresholds

New law

- Increases CTC to $2,000
- Increases income level at which CTC begins to phase out to $400,000 for married filing jointly ($200,000 for all other taxpayers).
- Limits refundable credit per child to $1,400, but capped at 15% of earned income, for married filing jointly
- Provides new, nonrefundable dependent credit ($500)

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway

- Significantly increases the threshold at which the proposed credit begins to phase out

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.41

Legislative text (H.R. 1-20)

Qualified tuition plans (IRC Section 529)

Prior law

- Allowed individuals to pay the qualified higher education expenses of a designated beneficiary through a Section 529 qualified tuition plan established as either a prepaid tuition program or a college savings program

New law

- Allows tax-free rollovers from Section 529 plans to ABLE accounts, as well as distributions totalling up to $10,000/year to pay elementary or secondary school tuition

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway

- Makes available Section 529 benefits to pay not only college tuition expenses but also K-12 tuition expenses, up to $10,000/year

Resources

Tax Alert 2017-2168

Joint Explanatory Statement p.60

Legislative text (H.R. 1-22)

Mortgage interest deduction (IRC Section 163(h)(3))

Prior law

- Allowed deduction for interest on acquisition and/or home equity indebtedness secured by a principal or second residence up to certain limits: $1 million limit for acquisition indebtedness; $100,000 limit for home equity indebtedness

New law

- Reduces to $750,000 the amount of acquisition indebtedness on a qualified residence for which an interest deduction may be claimed for tax years
- Eliminates interest deductions pertaining to home equity loans unless the loan is used to "buy, build, or substantially improve the taxpayer's home that secures the loan"

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway

- Does not apply to mortgages entered on or before 15 December 2017, or to refinancing after that date, as long as the amount of new mortgage does not exceed the amount of the mortgage being refinanced

Resources

[See a detailed description of this provision](#)

[Tax Alert 2017-2168](#)

[Joint Explanatory Statement p.76](#)

[Legislative text (H.R. 1-33)](#)

[IR-2018-32](#)

[Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform](#)

State and local tax deduction (IRC Section 164(b))

Prior law

- Allowed itemized deduction for state and local government income and property taxes paid, or sales taxes in lieu of income taxes

New law

- Repeals state and local tax deduction generally, but allows a deduction of up to $10,000 ($5,000 if married filing separately) for the aggregate amount of state and local real property tax, plus state and local income tax (or, as an alternative to income taxes, state and local sales taxes)
- Repeals deduction for personal property taxes
- Retains deduction for foreign income taxes (to the extent not taken as a credit)

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaways

- Significantly affects individual taxpayers in high-tax states (e.g., New York, New Jersey, California)
- Does not affect deductions for foreign income taxes (in lieu of a credit) or for real property taxes on property held for investment

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.78

Legislative text (H.R. 1-32)

IR-2017-210

Webcast: Wealth and asset management state and local tax technical update

Charitable contributions (IRC Section 170(b)(1))

Prior law

- Allowed itemized deductions for charitable contributions, limited to 50% of adjusted gross income (AGI), for cash and capital gain property contributions to public charities and certain private foundations

New law

- Increases charitable deduction limit to 60% of AGI for cash and capital gain property contributions to public charities and certain private foundations
- Repeals, effective after 2017, charitable contribution deduction of 80% of the amount paid for the right to purchase tickets for athletic events
- Repeals, effective after 2016, special rule for substantiation exception for contributions reported by donee

Effective date

- Effective for tax years beginning after 2017 and before 2026

Implications/ key takeaway

- Only applies to cash contributions in 2018 and thereafter; therefore, cash contributions made in 2017 or earlier and carried forward into 2018 will retain their 50% AGI limitation

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.83

Legislative text (H.R. 1-21)

Webcast: Next steps for individuals, estates, trusts and pass-through entities under tax reform

Out-of-pocket medical expenses (IRC Section 213(f))

Prior law	Allowed individuals to claim itemized deductions for unreimbursed medical expenses that exceeded 10% of AGI (or exceeded 7.5% of AGI if the taxpayer had reached age 65 before the close of the tax year)
New law	Reduces the threshold for deducting medical expenses to 7.5% of AGI for both regular tax and AMT purposes
Effective date	Effective for tax years 2017 through 2018
Implications/ key takeaway	Returns the threshold amount to pre-2010 levels for 2017 and 2018

Resources

Tax Alert 2017-2168

Joint Explanatory Statement p.99

Legislative text (H.R. 1-24)

ACA individual shared responsibility payment (IRC Section 5000A)

Prior law

- Required, under the Patient Protection and Affordable Care Act (known as the ACA), individuals to be covered by a health plan that provides minimum essential coverage
- Imposed a tax on individuals not covered by such a plan

New law

- Reduces the amount of the individual shared responsibility payment to zero

Effective date

- Effective for health coverage status for months beginning after 31 December 2018

Implications/ key takeaway

- Reduces the individual penalty for not having health insurance to zero
- Does not affect other ACA provisions, including the 3.8% net investment income tax or the 0.9% additional Medicare tax, which remain in effect

Resources

Tax Alert 2017-2168

Joint Explanatory Statement p.153

Legislative text (H.R. 1-39)

Roth recharacterization as traditional IRA (Section 408A(d)(6)(B))

Prior law

- Allowed individuals to recharacterize traditional IRA contributions into Roth IRA contributions or vice versa by making a trustee-to-trustee transfer before the income tax due date

New law

- Prohibits individuals from reversing the conversion of traditional IRA contributions into Roth IRA contributions, so elections to convert to a Roth IRA may not be unwound
- Continues allowing individuals to recharacterize contributions to a Roth IRA as contributions to a traditional IRA, before the income tax due date for that year

Effective date

- Effective for tax years beginning after 2017, but individuals may recharacterize 2017 Roth IRA conversions through 15 October 2018, according to IRS guidance

Implications/ key takeaway

- Eliminates the benefit of the taxpayer's use of hindsight by eliminating the ability to recharacterize a conversion if assets in a Roth IRA decline

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.113

Legislative text (H.R. 1-112)

IRA FAQs – Recharacterization of IRS contributions

IRS Publication 590-A

Estate, gift and generation-skipping transfer tax (Section IRC 2010(c)(3))

Prior law	Taxed property inherited through an estate or received as a gift at a top rate of 40%, excluding the first $5 million in transferred property as exempt from any combination of estate, gift or generation, skipping transfer (GST) taxes
New law	Increases the Section 2010(c)(3) basic exclusion amount to $10 million, indexed for inflation occurring after 2011
Effective date	Effective for tax years beginning after 2017 and before 2026
Implications/ key takeaway	Subjects many fewer estates to the estate tax and leaves intact the current law that allows beneficiaries who inherit from a decedent's estate to receive a step-up in basis

Resources

See a detailed description of this provision

Tax Alert 2017-2168

Joint Explanatory Statement p.134

Legislative text (H.R. 1-38)

Other adjusted provisions

Alimony payments

Repeals payor's deduction for alimony payments and payee's corresponding inclusion in gross income, effective for divorce decrees and separation agreements executed after 2018, as well as post-2018 modifications to existing divorce decrees or separation agreements if they expressly state that this change is intended

Pension plan loans

Gives an employee whose plan terminates with a plan loan outstanding until the tax return due date for that year to move the loan balance to an IRA to avoid having the loan taxed as a distribution beginning after 2017

Kiddie tax

Applies ordinary and capital gains rates for trusts and estates to net unearned income of children; effective for tax years beginning after 2017 and before 2026

Credit program integrity

Requires valid Social Security number (SSN) of each child to claim refundable portion of child tax credit (CTC); effective for tax years beginning after 2017 and before 2026

Student loan indebtedness

Excludes from income any discharge of student loan indebtedness resulting from death or total disability of the student; effective for tax years beginning after 2017 and before 2026

Personal casualty losses

Limits personal casualty deductions to losses incurred in federally declared disasters for tax years beginning after 2017 and before 2026

Other adjusted provisions (cont.)

Section 529A plans

Increases contribution limitation to ABLE accounts under certain conditions; allows designated beneficiary of an ABLE account to claim the saver's credit for contributions

Installment agreements

Generally prohibits increases in the amount of user fees charged by the IRS for installment agreements, beginning after 2017 and before 2026

Contesting IRS levy

Extends from nine months to two years the period for returning the monetary proceeds from the sale of property that has been wrongfully levied upon, beginning after 2017 and before 2026

Wagering loss deduction

Provides that losses from wagering transactions include not only the actual cost of wagers, but also other expenses in connection with the conduct of gambling activity beginning after 2017 and before 2026

Educator expenses

Increases the limit for the deduction of certain educator expenses to $500 for tax years beginning after 2017 and before 2026

Public safety volunteers

Increases to $6,000 the aggregate amount of length-of-service awards that may accrue for a bona fide public safety volunteer and adjusts for cost-of-living increases beginning after 2017

Other adjusted provisions (cont.)

Whistleblower program

Provides an above-the-line deduction for attorneys' fees and court costs paid by whistleblowers for tax years beginning after 2017 and before 2026

Wrongful incarceration

Extends for one year the waiver on statute of limitations for seeking credit or refund for tax paid on damages/restitution received by wrongfully incarcerated individuals; must have filed claim before 18 December 2017

Significant retained provisions

Capital gains and dividends rates

Retains current rates; indexes breakpoints using Chained CPI-U; retains 3.8% net investment income tax

Adoption credit

Retains nonrefundable tax credit for qualified adoption expenses paid to adopt an eligible child

Earned income tax credit

Retains earned income tax credit, which is available to working people with low-to-moderate income

Disability credit

Retains 15% credit available to every citizen and resident over age 65 or retired on permanent and total disability

Mortgage credit certificate

Retains availability of mortgage credit certificate, reducing the federal tax liability of a qualified borrower

Plug-in electric vehicles credit

Retains tax credit for the purchase of a new qualified plug-in electric drive motor vehicle

Individual

Significant retained provisions (cont.)

Qualified tuition

Retains above-the-line deduction for qualified tuition and related expenses

Coverdell education accounts

Retains education savings accounts (under Section 530) used to pay qualified education expenses on behalf of designated beneficiaries

Higher education payments

Retains exclusion from income for interest on US savings bonds used to pay for higher education

Student loan interest deduction

Retains deduction allowed for student loan interest paid during the year on a qualified student loan, including both required and voluntarily prepaid interest payments

Nondiscrimination rules

Retains rules prohibiting qualified retirement plans from discriminating in favor of highly compensated employees

Education assistance

Retains annual exclusion (up to $5,250) from an employee's income for educational assistance under a program that meets certain criteria

Individual

Significant retained provisions (cont.)

American Opportunity Tax Credit

Retains credit for qualified education expenses paid for an eligible student for first four years of higher education

Medical savings accounts

Retains above-the-line deduction for contributions to an Archer Medical Savings Account (MSA) and exclusion of employer contributions from income

Adoption assistance

Retains maximum $13,570 exclusion for qualified adoption expenses paid or reimbursed by an employer

Dependent care assistance

Retains $5,000 annual exclusion for employer-provided dependent care assistance

In-service distributions

Retains current minimum age for allowable in-service employee-sponsored retirement distributions

Significant repealed provisions

Personal exemptions

Repeals deduction for personal exemptions for tax years beginning after 2017 and before 2026

Itemized deductions

Repeals overall limitation on itemized deductions for tax years beginning after 2017 and before 2026

Tax preparation

Repeals tax preparation deduction for tax years beginning after 2017 and before 2026

Moving expenses

Repeals moving expenses deduction for tax years beginning after 2017 and before 2026, except for Armed Forces members

Significant repealed provisions (cont.)

Employer-provided bicycle commuter exclusion

Repeals exclusion of qualified bicycle commuting reimbursements of up to $20 per qualifying bicycle commuting month, beginning after 2017 and before 2026

Living expense deduction for Congress members

Eliminates deduction for living expenses incurred by members of Congress, effective after 22 December 2017

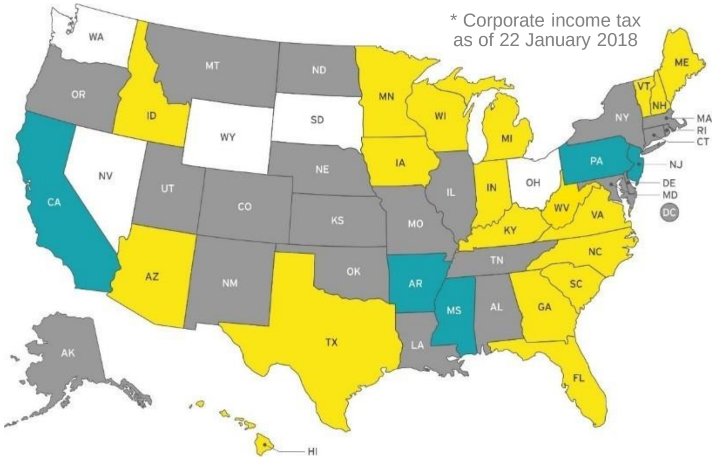
State tax considerations

The Tax Cuts and Jobs Act
Tax Guide

Corporate/business implications

Conformity is the key

- Which states will conform? When will they conform? How will they conform?



* Corporate income tax as of 22 January 2018

- States likely will conform to federal base expansion provisions but not to rate reductions. State tax revenues are expected to increase.
- Although a fixed conformity state as of 1 January 2015 for most corporate purposes, California is a rolling conformity state for select provisions of subpart F that it has incorporated.
- Corporate taxpayers in Michigan can elect to compute their state tax based on the Internal Revenue Code (IRC) as of 1 January 2012 or as in effect for the current tax year.
- States may decouple from numerous provisions, including 100% bonus depreciation, Section 179 expensing and the indefinite carryforward of NOLs (states generally have their own rules).

Key:

Rolling IRC conformity:

- State income tax law generally conforms automatically to IRC changes upon federal enactment.
- Expanded tax base from federal tax reform without a rate reduction may result in increases in state income tax liabilities.
- In the short term, expect state tax rates to go unchanged.

Fixed IRC conformity:

- State income tax law generally doesn't conform to IRC changes unless the state updates its IRC conformity date to one on or after the date of federal changes.
- Until the state updates its conformity date, taxpayers could be subject to two different tax systems.
- Federal tax reform generally has no impact on state income tax.

Selective IRC conformity:

- State income tax law generally conforms only to certain IRC changes, or certain IRC provisions as of a specific date, or makes significant changes to IRC provisions, or there are other circumstances that warrant the designation.

No corporate income tax

Resources

- *Tax Alert 2017-2171*
- *Tax Alert 2018-0354*
- *Tax Alert 2018-0622*
- *Tax Alert 2018-0666*
- *Tax Alert 2018-0678*
- *Tax Alert 2018-0720*
- *Tax Alert 2018-0730*
- *Tax Alert 2018-0735*
- *Tax Alert 2018-0736*
- *Tax Alert 2018-0819*
- *Tax Alert 2018-0842*

Corporate/business implications (cont.)

DRD

- Affects the state income tax determination in those few states that conform to the federal DRD rules (i.e., those states that directly rely upon federal taxable income *after* NOL and special deductions (e.g., Maryland and Virginia) or that otherwise incorporate or follow select relevant federal provisions)
  - Note: Most states have their own DRD percentage ownership requirements that qualify for a specific range of percentage deduction and most of which vary widely from their federal equivalent.

Expensing and **qualified property expensing**

- Remember many states already decouple from bonus depreciation (Section 168(k)) and immediate expensing (Section 179) for income tax purposes
- Expect decoupling efforts to continue with qualified property expensing (i.e., 100% bonus depreciation) and the expansion of Section 179, which will further exacerbate the differences between federal and state asset basis
- Consider working with coalitions to promote legislation to "recouple" states to Section 168(k) (both to compensate for anticipated increased state revenues from decoupling and simplification)
- Evaluate the feasibility of making certain federal or state depreciation elections to maximize resulting state depreciation expense
- Determine the impact of immediate expensing on any special state qualifications (such as New York manufacturer status)
- Expect states to be very active in attempting to attract anticipated increased US investments in qualified property through aggressive and possibly creative use of statutory and negotiated credits and incentives (C&I)
- Identify and implement C&I opportunities

Resources

- *Tax Alert 2017-2171*
- *Tax Alert 2018-0354*
- *Tax Alert 2018-0622*
- *Tax Alert 2018-0666*
- *Tax Alert 2018-0678*
- *Tax Alert 2018-0720*
- *Tax Alert 2018-0730*
- *Tax Alert 2018-0735*
- *Tax Alert 2018-0736*
- *Tax Alert 2018-0819*
- *Tax Alert 2018-0842*

Corporate/business implications (cont.)

Interest limitation

- Evaluate the state income tax impact of the new interest limitation and consider planning opportunities
- Expect states to generally follow the interest limitation provision, including the carryforward period, because most states use federal taxable income as the starting point to determine state taxable income, absent legislative decoupling
- Expect states to re-evaluate their positions vis-à-vis business interest expense in light of this new federal interest limitation
- Expect certain states to seek to determine the interest limitation at the individual entity level, as potential allocations of the consolidated interest limitation among affiliated group members for federal purposes may not be respected for state tax purposes
- Remember, if states determine the interest limitation at the individual entity level, there could be wide disparities in the interest limitation at the state versus federal level
- Remember interest limitation carryovers will be a new federal tax attribute that generally can be carried over to acquiring entities under Section 381, but are also subject to valuation limitations under Section 382
  - Note: States vary widely on conformity to these provisions, and potential state disconnects are possible.
- Consider that, in some cases, the state interest limitation carryover might be eliminated if the state symmetrically follows its existing conformity to these new federal rules
- Consider working with state government leaders to revisit whether decoupling from bonus depreciation and immediate expensing continues to be appropriate and consistent with development efforts

Resources

Tax Alert 2017-2171
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Corporate/business implications (cont.)

NOLs

- Affects the state income tax determination in those few states that conform to the federal NOL rules (i.e., those states that directly rely upon federal taxable income *after* NOL and special deductions (e.g., Maryland and Virginia) or that otherwise incorporate or follow select relevant federal provisions)
- Expect states to re-evaluate their historic treatment of NOLs, particularly carryback and carryforward periods, as a result of the federal changes to NOLs

Pass-through deduction

- Affects the state income tax determination in those few states that use federal AGI, rather than federal taxable income, as the starting point for their personal income tax base (thus, the pass-through deduction may not apply in most states that impose a personal income tax unless they legislatively conform)
  - Remember that, for federal tax purposes, the 20% pass-through deduction for individuals is made against taxable income instead of AGI
- Evaluate and consider state income tax issues and opportunities in response to federal tax planning seeking to use the new lower corporate income tax rate (subject to reduced federal income tax rates for dividends and capital gains, owners may find deferral and sourcing attractive in converting their pass-through entity into a C corporation)
  - Consider that the nearly 40% decline in the federal corporate income tax rate to 21%, the $10,000 annual limitation of the state and local tax deduction, and the correlative effect of the limitation on the costs of state taxes for pass-through entities have created a paradigm shift in thinking about whether operating as a C corporation is more beneficial than as a pass-through entity
  - Remember that the myriad of state entity-level taxes and shareholder residency issues complicate an astonishingly new array of entity selection options that could provide beneficial tax savings

Resources

Tax Alert 2017-2171
Tax Alert 2018-0354
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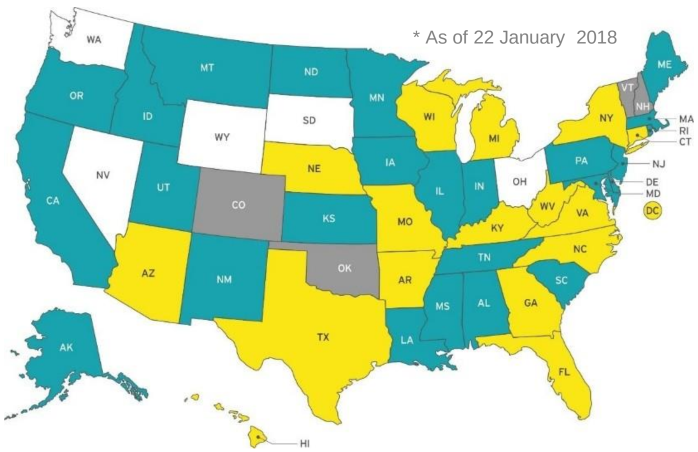
International implications

Transition tax

- Taxpayers should evaluate and model the state income tax impact of the transition tax (the “Day 1” event), as well as consider planning opportunities.
- The state impact of the transition tax (the “Day 1” event) on conforming states will primarily be driven by each state’s treatment of subpart F income, as well as its treatment of the corresponding deduction, and will often be affected by the “mechanical” reflection of these amounts on the federal return for the 2017 tax year. Many states treat subpart F income as dividends and apply their own DRD rules, but taxpayers should not forget about state expense disallowance rules.
- The following map summarizes state law conformity to the **pre-tax reform** subpart F income regime. Will states subject transition tax amounts to their current treatment of subpart F income?



Key:

- No modification (potentially taxable)
- Full modification (generally not taxable)
- Special rules (taxability typically impacted by percentage ownership of subsidiary or state return filing methodology)
- No corporate income tax

- Will state conformity to the transition tax violate the Foreign Commerce Clause of the US Constitution? See, for example, *Kraft General Foods, Inc. v. Iowa Dept. of Rev. & Fin.*, 505 U.S. 71 (1992), which holds that states cannot tax dividends from foreign subsidiaries differently than dividends from domestic subsidiaries.
- Some unitary combined reporting states may not agree that conformity violates the Foreign Commerce Clause. See, for example, *E. I. Du Pont de Nemours & Co. v. State Tax Assessor*, 675 A.2d 82 (Maine, 1996), and *Appeal of Morton Thiokol, Inc.*, 864 P.2d 1175 (Kansas, 1993).

Resources

- *Tax Alert 2017-2171*
- *Tax Alert 2018-0354*
- *Tax Alert 2018-0622*
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- *Tax Alert 2018-0819*
- *Tax Alert 2018-0842*

International implications (cont.)

Dividends received from foreign subsidiaries

- Evaluate and model the state income tax impact of future distributions in all relevant states, with emphasis on determining state conformity to the new Section 245A federal DRD for foreign dividends, particularly in the few "Line 30" starting point states, and consider planning opportunities
- Remember the state impact of future actual distributions from foreign subsidiaries can be significant, given that future foreign dividends, and even future actual distributions that are excluded from federal taxable income under the federal previously taxed income (PTI) regime, may be taxable in certain states
- Remember that California can present a myriad of issues and opportunities for taxpayers based on their specific facts and circumstances, particularly since the state does not directly follow the federal treatment of PTI
- Evaluate the potential impact of state PTI regimes, whether codified or not, and determine ways in which the distributed foreign subsidiary earnings may have been previously subject to tax in the state (e.g., tax haven rules, "80/20" rules and related-party addbacks are all ways in which a state might have previously subjected the earnings of a foreign subsidiary to tax)
- Evaluate the applicability of *Kraft* and whether favorable filing positions may exist
- Expect states to be very active in attempting to attract anticipated US inbound investments from repatriated funds through aggressive and possibly creative use of statutory and negotiated C&I
- Identify and implement C&I opportunities

GILTI and deduction for FDII and GILTI

- Evaluate and model the state income impact of these new provisions, and consider planning opportunities
- Remember that, based on states' conformity provisions, it is not clear that all states will conform to the new GILTI inclusion or how the GILTI inclusion fits within a state's current approach to subpart F income

Resources

Tax Alert 2017-2171
Tax Alert 2018-0354
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International implications (cont.)

GILTI and deduction for FDII and GILTI (cont.)

- Consider that it is unclear whether the corresponding GILTI/FDII deduction will be determined at Line 28 (federal taxable income before NOL and special deductions) or as a special deduction reported on Line 29b of the federal income tax return
- Remember, how a state conforms to the "mechanical" federal treatment of this deduction could be important to the ultimate treatment at the state level
- Consider that state conformity to these provisions raises US constitutional questions under the Foreign Commerce Clause, as such taxes could operate as tariffs, which are precluded under the Import-Export Clause for state tax purposes; might *Kraft* precedent come into play as well?

BEAT

- Remember that the BEAT is not directly incorporated into a determination of federal taxable income and, thus, not directly incorporated into state income tax bases (similar to the federal corporate AMT)
- Remember that states already deploy their own tools in the form of related-party interest and other expense addbacks that may be more restrictive and could conflict with the BEAT, so it is questionable whether a state would want to enact (or constitutionally could enact) a similar regime
- Evaluate and consider state income tax issues and opportunities in response to federal/international tax planning surrounding the BEAT (both "numerator" and "denominator" planning) (e.g., restructurings that seemingly occur completely outside the US, changes to federal COGS, or "gross vs net" changes to the federal corporate income tax return, could have significant state income tax implications, which would need to be addressed)
- Note that the Texas franchise tax base might include the gross amount in the tax base but not provide for the corresponding deduction, while the computation of the numerator and denominator of the sales apportionment factor in other states could be distorted by any such federal recast of the transactions

Resources

Tax Alert 2017-2171
Tax Alert 2018-0354
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Tax Alert 2018-0842

Individual implications (cont.)

State and local tax deduction

- Do not expect the new $10,000 cap for state and local taxes to have a significant direct revenue impact on state governments since state and local income taxes for individuals (as for corporations) have always generally been an "addback" in determining state taxable income.
- May embolden state tax policymakers to completely transform their systems of business taxation due to the dramatic increase in relative costs of state taxes to individuals and the possibility of imposing entity-level taxes that continue to be deductible for federal income tax purposes
- Consider contacting state governments about changing the state income tax structure to replace income taxes imposed on the owners with an entity-level tax that would remain deductible

Resources

Tax Alert 2017-2171
Tax Alert 2018-0354
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Tax Alert 2018-0842

Tax accounting considerations

The Tax Cuts and Jobs Act
Tax Guide

Corporate/business implications

Corporate rate

- Recognize the effect of a change in tax rate on deferred tax assets and liabilities as a component of income tax expense from continuing operations in the period of enactment
- Include in income from continuing operations adjustments to deferred tax balances related to the enacted change in tax rate, regardless of whether the deferred tax balances originated from charges or credits to another category of income (e.g., discontinued operations or other comprehensive income)
- Remeasure federal deferred tax effects of state deferred taxes and unrecognized tax benefits related to state taxes

DRD

- Reflect the new DRD rules in the measurement of the deferred tax liabilities related to outside basis differences
- Consider state DRD rules, as most states provide their own DRD separate from federal

AMT

- Recognize any benefits associated with the reversal of valuation allowances against existing AMT credit carryforwards in the period of enactment
- Evaluate the balance sheet classification of AMT credit carryforwards after the enactment date

Qualified property expensing

- Consider the implications of accelerated capital expensing on deferred tax balances as of the period of enactment
- Identify which states will automatically conform by statute to the new federal cost recovery provisions for capital expenditures and consider the impact on current and deferred state taxes

Resources

Tax Accounting Insights – A closer look at accounting for the effects of the Tax Cuts and Jobs Act

Corporate/business implications (cont.)

Interest limitation

- Assess the need for a valuation allowance on any resulting deferred tax assets for interest carried forward if the company has interest limited under the new provision
- Consider the impact future disallowed interest may have on projections of future taxable income used for valuation allowance analysis on other existing deferred tax assets

NOLs

- Re-evaluate the realizability of any remaining NOL carryforwards (after appropriate remeasurement for the change in tax rates) after considering NOLs used to offset any transition tax
- Should prompt companies that rely on projections of future taxable income when evaluating the realizability of existing deferred tax assets, including NOL and tax credit carryforwards, to consider whether other provisions of the Act will affect their ability to use NOLs in the future (e.g., the limitation on the use of an NOL created after 31 December 2017 to 80% of the taxable income in any year)

Domestic production deduction

- Exclude the Section 199 deduction effect in projecting taxable income after the effective date in determining the need for a valuation allowance for an entity's existing deferred tax assets
- Consider providing, if material, early-warning disclosures to help financial statement users understand the change in the historical effective tax rate

Resources

Tax Accounting Insights – A closer look at accounting for the effects of the Tax Cuts and Jobs Act

Corporate/business implications (cont.)

Entertainment expenses & fringe benefits

- Review the general ledger accounts used to capture meal and entertainment expenses for any potential new permanent differences

Nondeductibility of amounts paid to government as part of an investigation

- Consider adjusting the estimated annual effective tax rate to eliminate the tax benefits repealed in the interim period that the change is effective

Limitation on excessive employee remuneration

- Consider whether all of the deferred tax assets for equity-based awards meet the transition grandfathering provisions
- Consider the impact of the expansion of the Section 162(m) limitation on the annual effective tax rate

Sexual harassment NDA

- Consider the effect on deferred tax assets recorded in the past for these settlements
- Note the nondeductibility of certain payments made to governments for violations of law

State tax conformity

- Review states for conformity to the Act's changes (i.e., rolling, fixed, selective)
- Monitor subsequent state tax legislation for further conformity and decoupling changes
- Review changes to future state taxable income projections for impact on realizability of state deferred tax assets and resulting valuation allowance conclusions

Resources

Tax Accounting Insights – A closer look at accounting for the effects of the Tax Cuts and Jobs Act

International implications

Dividends received from foreign subsidiaries

- Carefully analyze the 10% ownership and holding period requirements contained in the provision for applicability of the new DRD rules to the measurement of deferreds on remaining outside basis differences after accounting for the transition tax
- Analyze and declare intentions with respect to whether investments in foreign subsidiaries are indefinitely reinvested
- Determine whether state taxes should be recognized for outside basis differences and the appropriate state tax rate to measure those deferred tax liabilities, as many states will treat foreign dividends, distributions out of PTI and subpart F income differently

Transition tax

- Validate US tax attributes, such as earnings and profits accumulated after 1986, previously taxed income and foreign tax credit pools
- Consider the impact on the balance sheet classification between current and non-current taxes payable
- Consider the effect on current state tax expense for calendar year-end companies if the state taxes a component of the transition tax on accumulated E&P
- Consider the effects of any state disallowances of expenses attributable to nontaxable dividends, if and when applicable

GILTI

- Should prompt companies to consider their policy election to apply the GILTI to deferred tax items and how it will be applied

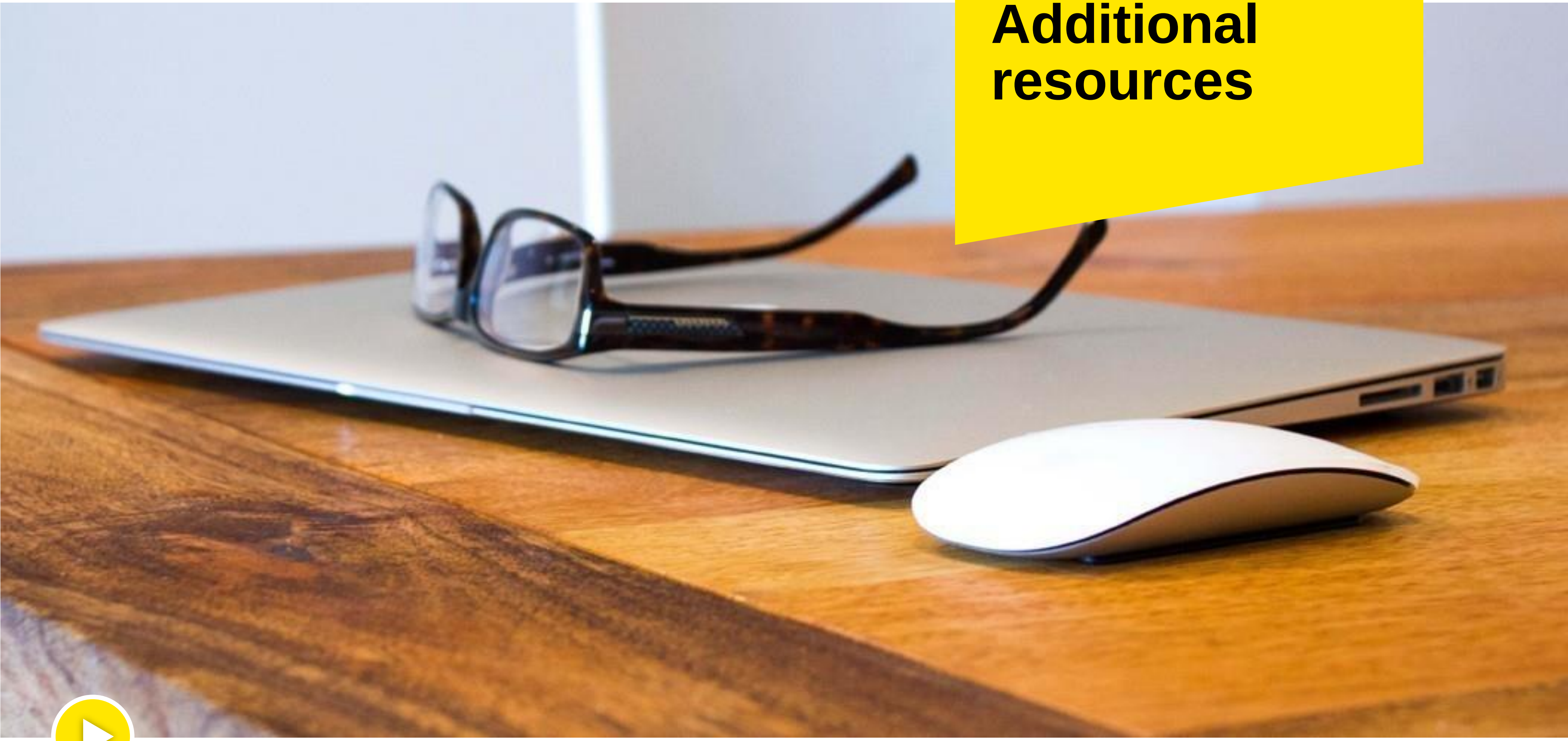
BEAT

- Review the FASB's published Q&A on the tax provision considerations of BEAT, in which it concluded BEAT should be treated as a period cost in the future as incurred

Resources

Tax Accounting Insights – A closer look at accounting for the effects of the Tax Cuts and Jobs Act

Additional resources



The Tax Cuts and Jobs Act

Tax Guide

Additional resources

- "'Tax Cuts & Jobs Act' Conference Agreement Released," Tax Alert 2017-2130, 16 December 2017
- "Numerous employer provisions retained in conference agreement on tax reform, IRS to delay 2018 income tax withholding tables," Tax Alert 2017-2132, 17 December 2017
- "Final tax reform bill includes significant changes for tax-exempt organizations," Tax Alert 2017-2142, 18 December 2017
- "A tax credits and incentives perspective on the tax reform bill Conference Agreement," Tax Alert 2017-2169, 20 December 2017
- "Summary of selected 'Tax Cuts and Jobs Act' tax rates and thresholds," Tax Alert 2017-2179, 21 December 2017
- "An employer's guide to the Tax Cuts and Jobs Act of 2017," 15 January 2018
- "US tax reform included changes to alcohol excise taxes," Tax Alert 2018-0109, 16 January 2018,
- "Deductibility of trustee fees after the Tax Cuts and Jobs Act," Tax Alert 2018-0157, 23 January 2018
- "Implications of certain tax reform provisions on research incentives," Tax Alert 2018-0373, 20 February 2018
- "Transportation fringe benefits — plotting a future course in the wake of the Tax Cuts and Jobs Act," Tax Alert 2018-0362, 20 February 2018
- "Tax Cuts and Jobs Act significantly affects US private companies with outbound investments," Tax Alert 2018-0251, 2 February 2018

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Corporate/business

Corporate rate

The Act taxes corporate income at a flat 21% rate and repeals the maximum corporate tax rate on net capital gain as obsolete. The Act does not provide a special rate for personal service corporations.

The Act did not amend the rules involving rate changes for fiscal-year taxpayers, so corporations with a fiscal tax year that overlaps with and includes 1 January 2018 will have a 'blended' tax rate for the year.

Corporate/business

Dividends received deduction (DRD)

The Act reduces the 70% dividends received deduction to 50% and the 80% dividends received deduction to 65% in order to reflect the lower corporate tax rate. Such dividends will be taxed at a maximum rate of 10% (i.e., 50% of the top corporate tax rate of 21%) and 7% (i.e., 35% of the top corporate rate of 21%), respectively.

Corporate/business

Alternative minimum tax (AMT)

The Act repeals the corporate AMT. Taxpayers with an AMT credit can use the credit to offset regular tax liability. Taxpayers may claim a refund of 50% (100% for years beginning in 2021) of the remaining credits (to the extent the credits exceed regular tax for the year) in tax years beginning before 2022. The provision applies to tax years beginning after 2017.

Expensing

The Act increases the expensing limitation under Section 179 from $510,000 to $1 million with the phase-out increasing from $2,030,000 to $2.5 million for tax years beginning after 2017.

The Act reduces the $1 million amount (but not below zero) by the amount by which the cost of the qualifying property placed in service during the tax year exceeds $2.5 million. Both expensing limitation amounts are indexed for inflation for tax years beginning after 2018. The Act also indexes the $25,000 sport utility vehicle limitation for inflation for tax years beginning after 2018.

The Act modifies the definition of qualified real property to:
(1) eliminate references to qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property, replacing such references with a reference to qualified improvement property; and (2) include the following improvements to nonresidential real property placed in service after the date the property was first placed in service:

- Roofs
- Heating, ventilation and air-conditioning property
- Fire protection and alarm systems
- Security systems

Simplified accounting for small businesses

The Act allows more taxpayers to use the cash method of accounting. Under the provision, taxpayers, other than tax shelters, are allowed to use the cash method of accounting if they satisfy the gross receipts test. Taxpayers satisfy the gross receipts test if their annual average gross receipts do not exceed $25 million for the three prior tax-year periods. The $25 million amount is indexed for inflation for tax years beginning after 2018.

The Act also extends the $25 million threshold to any farming C corporation or farming partnership with a C corporation partner. The Act retains the $25 million limit for family farm corporations.

Taxpayers that satisfy the $25 million gross receipts test are not required to maintain inventories, and may treat any inventories as non-incidental materials and supplies or follow financial accounting treatment. Likewise, such taxpayers are exempt from the application of the uniform capitalization rules in Section 263A and the regulations thereunder.

Corporate/business

Qualified property expensing

The Act extends the additional first year depreciation deduction through 2026 (2027 for longer production period property and certain aircraft). The Act allows taxpayers to claim 100% bonus depreciation with respect to qualified property acquired and placed in service after 27 September 2017, and before 1 January 2023 (1 January 2024, for certain qualified property with a longer production period, as well as certain aircraft). The Act phases down bonus depreciation to 80% for qualified property placed in service before 1 January 2024; 60% for qualified property placed in service before 1 January 2025; 40% for qualified property placed in service before 1 January 2026; and 20% for qualified property placed in service before 1 January 2027 (with an additional year to place in service available for long production period property and certain aircraft associated with each phase-down percentage). The Act also applies to certain plants planted or grafted after 27 September 2017, and before 1 January 2027, with similar bonus percentages in place.

The Act also expands the current law definition of qualified property by repealing the requirement that the original use of the property begin with the taxpayer; instead, property is generally eligible for 100% bonus depreciation if it is the taxpayer's first use of such property (provided that such "used" property is not acquired from a related party or in a carryover basis transaction).

The Act further expands the current law definition of qualified property to include certain qualified film and television productions, as well as certain qualified theatrical productions.

While the Act generally expands the definition of qualified property, it specifically states that qualified property does not include property used by a regulated public utility company in the trade or business of the furnishing or sale of: (1) electrical energy, water or sewage disposal services; (2) gas or steam through a local distribution system; or (3) transportation of gas or steam pipeline, if the rates for the furnishing or sale of such services have been established or approved by a state or political subdivision thereof, by an agency or instrumentality of the United States or by a public service or utility commission or other similar body of any state or political subdivision thereof.

Additionally, the Act states that qualified property does not include any property used in a trade or business that has had floor plan financing indebtedness (as defined in paragraph (9) of Section 163(j)), if the floor plan financing interest related to such indebtedness was taken into account in computing the interest limitation under Section 163(j). Further, a real property trade or business that elects not to be subject to certain interest provisions of Section 163(j) has to depreciate qualified improvement property under the alternative depreciation system (and thus, such property is not eligible for bonus depreciation).

Qualified property expensing (cont.)

Lastly, a farming business that elects not to be subject to certain interest provisions of Section 163(j) has to depreciate its property with a recovery period of 10 years or more under the alternative depreciation system (and thus, such property is not eligible for bonus depreciation).

The Act also repeals the election to accelerate AMT credits in lieu of bonus depreciation under Section 168(k)(4).

Interest limitation

The Act limits the net interest expense deduction for every business, regardless of form, to 30% of adjusted taxable income. The Act requires the interest expense disallowance to be determined at the tax filer level. Adjusted taxable income for purposes of this provision is a business's taxable income calculated without taking into account: (i) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (ii) any business interest or business interest income; (iii) NOLs; (iv) the amount of any deduction allowed under Section 199A; (v) in the case of tax years beginning before 1 January 2022, any deduction allowable for depreciation, amortization or depletion; and (vi) such other adjustments as provided by the Secretary of the Treasury. Adjusted taxable income also does not include the Section 199 deduction, as it is repealed.

The Act allows businesses to carry forward interest amounts disallowed under the provision to succeeding tax years indefinitely. Any carryforward of disallowed interest is an item taken into account in the case of certain corporate acquisitions described in Section 381 and is treated as a "pre-change loss" subject to limitation under Section 382.

The Act includes special rules to allow a pass-through entity's owners to use unused interest limitation for the tax year and to ensure that net income from pass-through entities is not double-counted at the partner level.

The Act exempts from these rules businesses with average annual gross receipts of $25 million or less for the three-tax-year period ending with the prior tax year. The provision also does not apply to certain regulated public utilities and, at the taxpayer's election, any real property trades or businesses.

Net operating losses (NOLs)

The Act allows indefinite carryforward of NOLs arising in tax years ending after 31 December 2017. The Act also repeals all carrybacks for losses generated in tax years ending after 31 December 2017, but provides a special two-year carryback for certain losses incurred in the trade or business of farming. For losses arising in tax years beginning after 31 December 2017, the Act limits the amount of NOLs that a taxpayer can use to offset taxable income to 80% of the taxpayer's taxable income.

NOLs that are farming losses for any tax year are treated as a separate NOL to be taken into account after the remaining portion of the NOL for such tax year.

As part of the repeal of NOL carrybacks, the Act repeals Section 172(f), the special rule allowing a 10-year carryback of specified liability losses.

Like-kind exchanges (LKEs)

The Act modifies Section 1031 so that its provisions only apply to LKEs of real property that is not held primarily for sale.

Corporate/business

Local lobbying expense deduction

The Act repeals Section 162(e)(2) and (e)(7), thereby prohibiting deductions for lobbying expenses for legislation before local government bodies (including Indian tribal governments).

Entertainment expenses and fringe benefits

The Act amends Section 274 to disallow entertainment expenses, even if directly related to or associated with business. As a result, for expenses paid or incurred after 31 December 2017, business entertainment is now entirely nondeductible unless eligible for one of the exceptions, which have not been modified.

The 50% disallowance that previously applied to meals and entertainment expenses now applies only to meal expenses. This change generally makes sense within the framework of the statutory change because the Section 274 disallowance now comprehensively disallows entertainment expenses without regard to whether the expense relates to a trade or business. There may, however, be a subset of entertainment expenses that are exempt from Section 274's primary disallowance by virtue of one of the exceptions — such as business meetings of employees, stockholders, agents, or directors, and meetings of business leagues — that would have been subject to the 50% disallowance under prior law, but are now fully deductible under the Act.

The 50% disallowance is amended to remove the exception for employer-provided eating facilities. As a result, in 2018, meals provided at such a facility will be more costly to the employer due to loss of half of the deduction.

Additionally, beginning in 2026, there will be no deduction available for meals provided either for the convenience of the employer or at an employer-operated eating facility. The Act does not modify the provisions in Section 132 and Section 119 excluding these meals from income.

Further, the qualified transportation fringe income exclusion remains available, except that the exclusion for qualified bicycle commuting reimbursements is suspended until 2026. The employer's deduction, however, generally is disallowed both for the expense of providing a qualified transportation fringe or for any payment or reimbursement, to an employee in connection with travel between the employee's residence and place of employment, except as necessary for ensuring the safety of the employee. The sole exception from this treatment is the qualified bicycle commuting reimbursement, which continues to be deductible until 2026. During that time, however, an employee cannot exclude the reimbursement from income.

Special rules for tax year of inclusion

The Act modifies the recognition of income rules by requiring a taxpayer to recognize income no later than the tax year in which the income is taken into account as income on an applicable financial statement or another financial statement under rules provided by the Secretary. Section 451(b) requires accrual-basis taxpayers to recognize income at the earlier of:

- When recognized for tax purposes under the all events test
  Or
- When taken into account in applicable financial statements.

This provision effectively requires taxpayers to recognize revenue at the earlier of when earned, due, received, or recognized for financial statement purposes. Section 451(b) does not provide simple book conformity, but rather requires taxpayers to carefully evaluate both tax rules and financial accounting rules to determine the appropriate timing for income tax recognition.

An exception applies for special methods of accounting, including, but not limited to, long-term contract income to which Section 460 applies, as well as installment sales under Section 453. Also, in the case of a contract that has multiple performance obligations, the Act requires the taxpayer to allocate the transaction price in accordance with the allocation made in the taxpayer's applicable financial statement.

Additionally, the Act codifies in Section 451(c) the one-year deferral for certain advance payments, which is treated as a method of accounting (per Section 451(c)(2)(B)).

There are important distinctions between qualifying items provided in Revenue Procedure 2004-34 and those provided in Section 451(c). First, Section 451(c)(4) limits the scope of an “advance payment” to a payment “[that] is for goods, services, or such other items as may be identified by the Secretary for purposes of this clause,” which leaves open whether additional guidance will be issued to include other items that qualify as advance payments under Revenue Procedure 2004-34, such as software. Second, the Committee report indicates the intent of the provision is to effectively repeal the deferral under Treas. Reg. Section 1.451-5.

The Act also requires taxpayers to apply the revenue recognition rules under Section 451 before applying the special rules under part V of subchapter P, which, in addition to the original issue discount (OID) rules, also includes rules regarding the treatment of market discounts on bonds, discounts on short-term obligations, OID on tax-exempt bonds, and stripped bonds and stripped coupons.

The Act provides an exception for any item of gross income in connection with a mortgage servicing contract. Finally, the Act retains rules for cash-basis taxpayers to include an amount in income when it is actually or constructively received.

This provision is effective for tax years beginning after 31 December 2017 and is implemented as a change in method of accounting.

Nondeductibility of amounts paid to government as part of an investigation

The Act denies a deduction for otherwise deductible amounts paid to a government or “specified nongovernmental entity” for violating a law or in relation to an investigation or inquiry by the government or entity into a potential violation of a law. Specifically, the Act indicates that the following nongovernmental entities shall be treated as governmental entities: (1) any nongovernmental entity that exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in Section 1256(g)(7)); and (2) to the extent provided in regulations, any nongovernmental entity that exercises self-regulatory powers (including imposing sanctions) as part of performing an essential governmental function.

The Act creates exceptions for: (1) payments that the taxpayer establishes that are either restitution or amounts required to come into compliance with a law that was violated or involved in the investigation or inquiry; (2) amounts paid or incurred as a result of a court order in a suit in which no government or governmental entity is a party; and (3) amounts paid or incurred as taxes due.

If a payment is considered restitution for failure to pay a tax, the restitution is deductible only to the extent the restitution payment would have been allowed as a deduction if it had been timely paid.

The Act applies only when a government or other entity treated in the same manner as a government is a complainant or investigator for violation or potential violation of a law. The Act requires government agencies or entities treated as agencies to report to the IRS and the taxpayer the amount of each settlement agreement or order entered into in which the aggregate amount required to be paid is at least $600 (or another amount that may be specified by the Secretary). The report will have to separately identify any amounts that are for restitution or remediation of property or correction of noncompliance. The Act requires the report to be made at the time the government or entity and the taxpayer enter into the agreement.

Corporate/business

Amortization of research or experimental (R&E) expenditures

For tax years beginning after 31 December 2021, the Act requires taxpayers to treat R&E expenditures as chargeable to a capital account and amortized over 5 years (15 years in the case of foreign research). The Act also modifies Section 174 to require that all software development costs be treated as R&E expenditures. Any capitalized R&E expenditures relating to property that is disposed of, retired, or abandoned during the amortization period must continue to be amortized throughout the remainder of the period.

Corporate/business

Character of self-created property

The Act no longer treats a self-created patent, invention, model or design, or secret formula or process as a capital asset. As such, gain or loss from the disposition of the property will be ordinary in character. Those items of property also will be excluded from the definition of property used in the trade or business under Section 1231.

Pass-through deduction

The Act: (1) contains a cap on the amount eligible for the 20% deduction that is based on the W-2 wages paid by the business, plus, in certain cases, the “unadjusted basis” of certain property used in the business; and (2) limits the availability of the deduction for individuals with income from certain “specified service businesses.” These limits do not apply to individuals with income below certain thresholds (the Thresholds — $157,500 for individuals, and $315,000 if married filing jointly, indexed annually).

QBI for a tax year means the “net amount of qualified items of income, gain, deduction and loss” from a taxpayer's qualified trade or business. For this purpose, "qualified items of income, gain, deduction and loss" are such items to the extent they are effectively connected with the conduct of a trade or business within the United States (within the meaning of Section 864(c) — i.e., they arise from regular, substantial and continuous business activities in the United States).

Qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income are not taken into account in determining QBI, but instead are separately eligible for a deduction without regard to the wage or property limitation mentioned earlier and discussed later. Thus, for example, 20% of qualified REIT dividends and 20% of qualified publicly traded partnership income may be included in the amount eligible for a deduction under Section 199A.

QBI does not include reasonable compensation paid by a qualified trade or business (including such compensation paid by an S corporation), any amounts paid by a partnership to a partner that are “guaranteed payments” under Section 707(c) with respect to the trade or business or (to the extent provided in regulations) payments to partners for services described in Section 707(a) with respect to the trade or business. It also does not include certain “investment items,” such as interest income not properly allocable to the trade or business and any capital gain or loss. In that regard, it is not clear if gain under Section 1231 that is treated as long-term capital gain is an amount excluded from the QBI computation. Generally, property that generates Section 1231 amounts is not considered investment property.

If the computation of QBI results in a loss for a tax year, the amount of the loss is carried forward and treated as a loss from a qualified business in the next tax year. It is not clear how or whether a net loss from qualified publicly traded partnership income affects the amount of the Section 199A deduction as it appears that the computation of the amount of the potential deduction under Section 199A nets the 20% or wage/property limited QBI amount with 20% of qualified publicly traded partnership income (along with 20% of qualified REIT dividends). As such, if the qualified publicly traded partnership income is a negative amount for a tax year, it is possible that such loss may reduce a taxpayer's total deduction under Section 199A.

Pass-through deduction (cont.)

W-2 wage limitation

In general, the amount of qualified trade or business income eligible for the Section 199A deduction is the lesser of: (1) 20% of the taxpayer's QBI from such trade or business; or (2) the greater of: (i) 50% of the W-2 wages of such trade or business, or (ii) the sum of 25% of the W-2 wages of such trade or business, plus 2.5% of the unadjusted basis immediately after acquisition of all "qualified property" of such business. Qualified property includes depreciable tangible property (not intangible property) that is used in the qualified trade or business. For taxpayers whose taxable income does not exceed the Thresholds, the W-2 wage and qualified property limitation does not apply. For taxpayers whose taxable income exceeds the Thresholds, the W-2 wage and qualified property limitation is phased in over the next $50,000 of income for individuals and $100,000 of income for married filing jointly taxpayers.

Special limitation for specified service businesses

The deduction does not apply to income from "specified service businesses" unless the taxpayer's income is below the Thresholds, and is phased out over the same income ranges used for the W-2 wage and qualified property limitation. A "specified service business" means any trade or business activity involving the performance of services in the fields of health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services, investment management, trading, dealing in securities, partnership interests or commodities, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its owners or employees. Engineering or architecture trades or businesses are not treated as specified service businesses.

The deduction also does not apply to the trade or business of performing services as an employee.

The provision is effective for tax years beginning after 31 December 2017 and before 1 January 2026.

Corporate/business

Carried interest

The Act creates Section 1061, which changes the one-year holding period under Section 1221 to a three-year holding period for certain capital gains of a taxpayer with respect to carried interests (defined as applicable partnership interests). An applicable partnership interest is one transferred to (or held by) a taxpayer in connection with the performance of services by the taxpayer or certain related persons in an "applicable trade or business." If the three-year holding period requirement is not satisfied, any capital gain recognized by the carried interest holder is treated as short-term capital gain, taxable at a partner's marginal income tax rate (e.g., as high as 37%). The Act does not otherwise change the nature or character of the income, and applies notwithstanding the application of Section 83 to the carried interest or whether a Section 83(b) election was made by the holder with respect to the carried interest.

Corporate/business

Business loss limitation

Under the Act, a taxpayer's “excess business loss” for the tax year will not be allowed. An excess business loss is the excess of: (1) the aggregate deductions attributable to trades or businesses of the taxpayer, over (2) the aggregate gross income or gain attributable to such trades or businesses, plus $250,000 ($500,000 for a joint return); for tax years beginning after 31 December 2018, these dollar amounts are indexed for inflation. Any loss disallowed by reason of this provision is treated as an NOL carryover to the following tax year under Section 172. The provision applies after application of Section 469. For an S corporation shareholder, the provision is applied at the shareholder level.

Under the Act, net operating loss carryovers are allowed for a tax year up to the lesser of the carryover amount of 80% of taxable income determined without regard to the deduction for NOLs.

The provision is effective for tax years beginning after 31 December 2017, and before 1 January 2026.

Sales of partnership interests by foreign partners

In *Grecian Magnesite* (*Grecian Magnesite Mining v. Commissioner,* 149 T.C. No. 3 (July 13, 2017)), the Tax Court declined to follow Revenue Ruling 91-32, holding the gain recognized by a foreign person on its redemption from a partnership engaged in a US trade or business did not result in effectively connected income (ECI).

The Act effectively reverses that decision, codifying a result similar to that of the ruling, such that gain or loss from the sale, exchange or disposition of a partnership interest by a foreign partner is treated as ECI if the partner’s share of the gain or loss from the sale or exchange of the underlying assets held by the partnership would be treated as ECI. In addition, the transferee of a partnership interest subject to the new rule is required to deduct and withhold 10% of the amount realized on the disposition unless, among other things, the transferor certifies that the transferor is not a foreign person (similar to the operation of the FIRPTA rules applicable to sales of US real estate by foreign owners).

The provision is effective for sales, exchanges and dispositions on or after 27 November 2017, while the effective date for required withholding on sales of partnership interests is effective for sales, exchanges, and dispositions after 31 December 2017.

Built-in loss definition on partnership loss transfers

The Act expands the scope of the mandatory basis adjustment rules of Section 743(d). In addition to the current requirement that a partnership adjust the basis in its assets upon the sale of a partnership interest if the partnership has a built-in loss of more than $250,000 in its assets, the Act requires a basis reduction if the purchaser of the partnership interest will be allocated a loss of more than $250,000 with respect to the purchased interest upon a hypothetical taxable disposition by the partnership of all of the partnership's assets for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.

The provision is effective for transfers of partnership interests after 31 December 2017.

Limitation on deduction of FDIC premiums

No deduction will be allowed for a certain percentage of premiums paid by banks to the Federal Deposit Insurance Corporation for tax years after 2017.

The deduction is disallowed for taxpayers with consolidated assets of $50 billion or more, and limited for smaller financial institutions.

The provision applies to tax years beginning after 31 December 2017.

Computation of life insurance tax reserves

In general, the method of computing reserves under Section 807(d) is significantly simplified to provide that the life insurance reserve for any contract is the greater of the net surrender value of the contract or 92.81% of the tax reserve method applicable to the contract. For variable insurance contracts, the tax reserve is the greater of: (i) the net surrender value, or (ii) the portion of the reserve that is separately accounted for under Section 817, plus 92.81% of the excess (if any) of the tax reserve method, over the net surrender value.

Section 807(d)(3) states that the term "tax reserve method" means: (i) the Commissioners Reserve Valuation Method (CRVM) for life insurance contracts; (ii) the Commissioners Annuity Reserve Valuation Method (CARVM) for annuity contracts; (iii) the method prescribed by the National Association of Insurance Commissioners (NAIC) as of the date the reserve is determined for any non-cancellable accident and health contracts; and (iv) the reserve method prescribed by the NAIC that covers such contract or, if no reserve method has been prescribed by the NAIC, a reserve method that is consistent with the reserve method under (i), (ii) or (iii). Notably, the law retains the rules disallowing deductions for deficiency and asset adequacy reserves.

A transition rule requires companies to recalculate reserves held on contracts issued before the effective date using the new reserve computation method. The difference between the reserves computed using the old method and the new method is taken into account over the subsequent eight years beginning in 2018.

Capitalization of certain policy acquisition expenses (tax DAC)

The Act modifies the tax deferred acquisition cost (DAC) percentages to account for the 21% corporate tax rate effective in 2018. Section 848 is modified by increasing the period over which specified policy acquisition expenses are amortized from 120 months to 180 months, retaining the prior law's three categories of specified insurance contracts, and increasing the tax DAC percentages.

The increased tax DAC percentages are as follows: for annuity contracts, 2.09%; for group life insurance contracts, 2.45%; and for all other specified insurance contracts, 9.20%. The changes to Section 848 are effective for tax years beginning after 2017 and, according to the Joint Committee on Taxation (JCT), increase revenues by $7.2 billion over 2018-2027.

Limitation on excessive employee remuneration

The Act amends Section 162(m) to expand the $1 million compensation deduction limitation for covered employees effective for tax years beginning after 31 December 2017. The Act includes a transition rule for compensation paid pursuant to a written binding contract that was in effect on 2 November 2017.

The Act eliminates the exception for performance-based compensation and expands the definition of covered employees. Covered employees include the CFO, plus any individual who has previously been a covered employee, even after the individual no longer holds the position. Thus, once an individual is identified as a covered employee, the deduction limitation would apply to the compensation paid to that individual, even after the individual no longer holds that position or has separated from service. In addition, any executive who is identified as a covered employee for a tax year after 31 December 2016, will remain a covered employee for all future years.

The Act also expands the definition of public company to include other securities registrants. It includes foreign private issuers, as well as private companies that have registered debt offerings and must report under Section 15(d) of the Securities Exchange Act.

The transition rule for binding contracts exempts from the Act's changes to Section 162(m) any compensation paid "pursuant to a written binding contract [that] was in effect on [2 November 2017], and [that] was not modified in any material respect on or after such date." This transition rule is identical in all material respects to the transition rule included in the statute when Section 162(m) was first enacted in 1993. That rule provided that "the term 'applicable employee remuneration' shall not include any remuneration payable under a written binding contract [that] was in effect on [17 February 1993], and [that] was not modified thereafter in any material respect before such remuneration is paid."

The Act's interpretation of this transition rule closely tracks to provisions of the Section 162(m) regulations' interpretation of the 1993 transition rule. The regulations interpret the 1993 transition rule narrowly to provide that it does not apply, unless the corporation is obligated under state law to pay the compensation as the employee performs the services. Similar to the regulations, the Act states that a contract renewed after 2 November is treated as a new contract. In addition, a contract that is terminable or cancelable unconditionally at will by either party without consent of the other is treated as a new contract entered on the date of the termination or cancellation.

Limitation on excessive employee remuneration (cont.)

Under the Act, compensation paid pursuant to a *plan* qualifies for the exception under the transition rule, but only if the right to participate in the plan is part of a written binding contract with the covered employee in effect on 2 November 2017.

The fact that a plan existed on 2 November is not by itself sufficient to qualify the plan for the exception for binding written contracts. If the covered employee has a written employment contract in effect on 2 November, providing that the executive is eligible to receive incentive compensation at a future date in accordance with plan terms, however, that employment contract may be sufficient to "grandfather" the payments made to the executive under the plan, provided that the employer does not have the right to amend the plan materially or terminate the plan (except on a prospective basis).

The Act does not address what constitutes a material modification of a contract or when a modification would constitute a new contract. The Treasury Department and the IRS are likely to look to the existing Section 162(m) regulations, which include detailed rules on what constitutes a material modification. Under the regulations, a material modification occurs when the contract is amended to increase the amount of the compensation payable to the employee. A material modification also may occur if payment of the compensation amount is accelerated or the parties agree to a supplemental arrangement to pay an additional amount of compensation.

Treasury and the IRS likely will rely on the existing Section 162(m) regulations to provide future guidance on what constitutes a binding written contract and also what constitutes a material modification of the contract that would create a new contract that would not be "grandfathered" under the transition rule.

Dividends received from foreign subsidiaries

The Act provides a 100% deduction for the foreign-source portion of dividends received by a domestic corporation from a foreign corporation (specified 10%-owned foreign corporation) with respect to which it is a US shareholder as defined in Section 951(b), as amended by the Act. A specified 10%-owned foreign corporation is any foreign corporation, other than a passive foreign investment company (PFIC) that is not a controlled foreign corporation (CFC), with respect to which any domestic corporation is a US shareholder. The 100% deduction is available to regulated investment companies or real estate investment trusts.

Any gain recognized by a domestic corporation on the sale or exchange of stock in a foreign corporation held for more than one year that is treated as a dividend under Section 1248, is treated as a dividend for purposes of the 100% deduction. Furthermore, the term "dividend" is to be interpreted broadly, consistent with Sections 243 and 245. As such, dividends received by a domestic corporation from a foreign corporation through a partnership that would be eligible for the 100% deduction if the domestic corporation owned the stock of the foreign corporation directly, are also eligible for the 100% deduction.

The foreign-source portion of a dividend received from a specified 10%-owned foreign corporation is the amount that bears the same ratio to the dividend as the undistributed foreign earnings of the specified 10%-owned foreign corporation bears to its total undistributed earnings. Undistributed earnings are the amount of earnings and profits (E&P) of the specified 10%-owned foreign corporation as of the close of its tax year in which the dividend is distributed, and not reduced by dividends distributed during such tax year. Undistributed foreign earnings are the portion of undistributed earnings that is attributable to neither: (1) income effectively connected with the conduct of a trade or business in the US (ECI) and subject to US federal income tax, nor (2) dividends received (directly or through a wholly owned foreign corporation) from a domestic corporation at least 80% of whose stock (by vote and value) is owned (directly or through such wholly owned foreign corporation) by the specified 10%-owned foreign corporation.

The 100% deduction, however, is not available for dividends received from a CFC that receives a deduction or other tax benefit under foreign tax law for the dividend (hybrid dividend). The Act refers only to dividends received from a CFC, but, because it refers to tax benefits received by a specified 10%-owned foreign corporation, it's unclear whether hybrid dividends received from a specified 10%-owned foreign corporation that is not a CFC remain eligible for the 100% deduction.

Dividends received from foreign subsidiaries (cont.)

Additionally, if a CFC with respect to which a domestic corporation is a US shareholder receives a hybrid dividend from any other CFC with respect to which such domestic corporation is also a US shareholder, that hybrid dividend is treated as subpart F income of the recipient CFC for the tax year in which the dividend is received.

Credits and deductions for foreign taxes (including withholding taxes) paid or accrued with respect to any dividend benefiting from the 100% deduction are disallowed. Additionally, for purposes of the foreign tax credit limitation under Section 904(a), the foreign-source income (and entire taxable income) of a US shareholder of a specified 10%-owned foreign corporation is determined without regard to:

1. The foreign-source portion of any dividend received from such foreign corporation
2. Deductions properly allocated and apportioned to: (a) income with respect to stock of the specified 10%-owned foreign corporation (other than subpart F income and global intangible low-taxed income); and (b) stock of the specified 10% foreign owned corporation (to the extent income with respect to such stock is not subpart F income or global intangible low-taxed income).

Thus, the Act appears to deny deductions for expenses associated with deductible dividends for purposes of the foreign tax credit limitation.

To be eligible for the 100% deduction, the domestic corporation must hold stock in the specified 10%-owned foreign corporation for more than 365 days during the 731-day period that begins on the date that is 365 days before the ex-dividend date. For this purpose, a taxpayer is treated as holding stock for any period only if the specified 10%-owned foreign corporation is a specified 10%-owned foreign corporation for such period, and the taxpayer is a US shareholder with respect to such specified 10%-owned foreign corporation for such period.

The 100% deduction does not apply to either foreign income directly earned by a domestic corporation through foreign branches or to capital gains recognized from the sale or exchange of stock in a specified 10%-owned foreign corporation.

Effective date

The 100% deduction applies to distributions made, including amounts received on the sale or exchange of stock of a foreign corporation treated as a dividend under Section 1248 (and for purposes of determining a taxpayer's foreign tax credit limitation under Section 904, deductions in tax years beginning), after 31 December 2017.

Transition tax

The Act requires a mandatory inclusion of the accumulated foreign earnings of a controlled foreign corporation (CFC) and other foreign corporations with a 10% domestic corporate shareholder (a 10/50 company), collectively referred to as specified foreign corporations, or SFCs. Whether a foreign corporation is an SFC is determined without the application of Section 958(b)(4) (preventing downward attribution from a foreign person to a US person), which is repealed for the foreign corporation's last year beginning before 1 January 2018. The mandatory inclusion is implemented by increasing the subpart F income of the SFC (treating a 10/50 company as a CFC solely for this purpose) in its last tax year beginning before 1 January 2018 (transition year), by the greater of its "accumulated post-1986 deferred foreign income" determined on 2 November 2017 or 31 December 2017.

The mandatory inclusion is subject to tax at reduced rates: 15.5% for earnings held in cash or other specified assets, and 8% for the remainder. The two rates are achieved by allowing a deduction against the required inclusion, based on the US shareholder's top marginal income tax rate in the inclusion year. However, there is a claw-back provision that subjects the entire mandatory inclusion amount to a 35% tax rate if a domestic corporation, which was subject to the transition tax, inverts within 10 years of the Act's enactment.

The Act allows a US shareholder to elect to pay the transition tax over eight years at 8% for the first five years, 15% in the sixth year, 20% in the seventh and 25% in the eighth. However, in the case of a Subchapter S corporation that has a mandatory inclusion, the Act permits each shareholder of the S corporation to elect to defer payment of its net tax liability with respect to the S corporation by reason of the mandatory inclusion until the tax year in which any of the following occurs first:

1. The corporation ceases to be an S corporation.
2. The S corporation liquidates or sells substantially all of its assets.
3. The S corporation ceases its business, ceases to exist or any similar circumstance.
4. The shareholder transfers shares in the S corporation; transfers of less than all of the stock in an S corporation are a triggering event only with respect to the transferred shares.

Transition tax (cont.)

Accumulated post-1986 deferred foreign income

The accumulated post-1986 deferred foreign income of an SFC means its E&P (i) accumulated in tax years ending after 31 December 1986, but only during periods in which the foreign corporation was an SFC, and determined as of 2 November 2017 or 31 December 2017 (measurement dates), whichever is greater, (ii) without diminution by reason of any dividends distributed during the SFC's transition year other than dividend distributions made to another SFC, and (iii) reduced by any E&P previously subject to US tax as effectively connected income or, in the case of a CFC, E&P which, if distributed, would be excluded from gross income of the US shareholder under Section 959 (e.g., income previously taxed under subpart F of the Code).

The US shareholder's mandatory inclusion is determined after taking into account any E&P deficits of its SFCs, thus effectively requiring inclusion of the net positive amount of deferred foreign income.

Further, a net deficit of one US shareholder (i.e., E&P deficits of its SFCs that exceed the accumulated post-1986 deferred foreign income of its SFCs) is allowed to offset the aggregate net positive amount of accumulated post-1986 deferred foreign income (i.e., the net amount remaining after taking into account E&P deficits of the US shareholder's SFCs) of another US shareholder if both US shareholders are members of the same affiliated group. In either instance, when a deficit of one foreign corporation is used to offset positive deferred foreign income of another corporation, foreign tax credits are stranded and unusable in a future year with the repeal of Section 902 in both the deficit corporation and the corporations to which a deficit is allocated. Regardless of the amount of deferred foreign income included in the mandatory inclusion, all accumulated post-1986 deferred foreign income (i.e., untaxed post-1986 E&P) is treated in the transition year (and until distributed) as though it were previously taxed subpart F income. Also, the E&P from an E&P deficit corporation is increased in the transition year by the amount of deficit allocated to another SFC.

Transition tax (cont.)

Cash and other specified assets

The 15.5% transition tax rate applies to an amount of the mandatory inclusion equal to a US shareholder's aggregate foreign cash position, which means the greater of the US shareholder's pro rata share of the aggregate cash position of its SFCs determined on the last day of the SFCs' year in which the mandatory inclusion occurs, or, the average of the US shareholder's aggregate pro rata share of the cash position of its SFCs determined in the two years ending immediately before 2 November 2017. So, the cash positions of a US shareholder with one SFC with a calendar tax year is determined as of 31 December 2017 or the average of 31 December 2016 and 31 December 2015, whichever is greater.

For purposes of this calculation, the cash position of an SFC includes the following: cash; net accounts receivable of the foreign corporation; and the fair market value of actively traded personal property, commercial paper, certificates of deposits, government securities, foreign currency, obligations with a term of less than a year, and any asset economically equivalent to these assets. To prevent double inclusions, the Act specifically excludes all or part of three items to the extent the US shareholder can demonstrate such cash amount is taken into account by the US shareholder's pro rata share of cash from another SFC. Such cash items include: (i) net accounts receivable, (ii) actively traded personal property (e.g., stock in an SFC), and (iii) obligations with a term of less than a year. For the foregoing calculations, the determination of whether a person is a US shareholder, whether a foreign corporation is subject to the transition tax, and the amount of a shareholder's pro rata share of a foreign corporation are all determined as of the end of the last tax year of a foreign corporation, which begins before 1 January 2018. Transactions with the principal purpose of reducing the aggregate cash position of a foreign corporation subject to the transition tax are disregarded.

Use of tax attributes to reduce the transition tax

Any foreign income taxes deemed paid by the US shareholder under Section 960 are reduced based on the same ratios applied to determine the allowable deduction against the mandatory inclusion. A gross-up under Section 78 is required only for the foreign income taxes remaining after the reduction ratios are applied, and this amount may be claimed as a credit against the transition tax liability (or other foreign-source income), subject to the normal limitations under Section 904. The Act also does not limit the use of a foreign tax credit carryforward of the US shareholder to offset the transition tax. The recapture of foreign losses under Sections 904(f) and 907(c)(4) was not turned off for the mandatory inclusion. However, US shareholders may elect to forgo the use of their NOL deduction to reduce US taxable income on the mandatory inclusion.

Global intangible low-taxed income (GILTI)

The Act requires a US shareholder of any CFC to include in gross income for a tax year its “global intangible low-taxed income” (GILTI) in a manner similar to current subpart F income inclusions. A US shareholder’s GILTI for any tax year means the excess, if any, of the US shareholder’s “net CFC tested income” over its “net deemed tangible income return.” In this manner, GILTI represents an amount deemed in excess of a specified return.

Net CFC tested income. A US shareholder’s net CFC tested income for a tax year equals the excess, if any, of: (i) the shareholder’s aggregate pro rata share of the “tested income” of each of its CFCs for the tax year, over (ii) the shareholder’s aggregate pro rata share of the “tested loss” of each of its CFCs for the tax year. Tested income of a CFC for a tax year means the excess, if any, of: (i) the CFC’s gross income for that year — but not including ECI, subpart F gross income, gross income excluded from “foreign base company income” or “insurance income” under the high-tax exception of Section 954(b)(4), dividends received from related persons within the meaning of Section 954(d)(3), and any foreign oil and gas extraction income within the meaning of Section 907(c)(1) (tested gross income) — over (ii) the deductions (including taxes) properly allocable (under rules similar to those of Section 954(b)(5)) to such tested gross income. Tested loss of a CFC is the excess, if any, of: (i) deductions properly allocable to its tested gross income, over (ii) its tested gross income. Accordingly, for any tax year, a CFC could have tested income or tested loss, but not both.

Net deemed tangible income return. A US shareholder’s net deemed tangible income return for a tax year equals the excess, if any, of: (i) 10% of the US shareholder's aggregate pro rata share of the “qualified business asset investment” (QBAI) of its CFCs over (ii) the amount of interest expense taken into account in determining the US shareholder’s net CFC tested income to the extent that the interest *income* attributable to the expense is not taken into account in determining the US shareholder’s net CFC tested income (e.g., interest payable to an unrelated lender). A CFC’s QBAI for any tax year means the average of its aggregate adjusted bases, measured as of the close of each quarter of the tax year, in tangible property used by the CFC in a trade or business for the production of tested income and for which a deduction is generally allowable under Section 167. The Treasury is authorized to issue anti-avoidance regulations (and other appropriate guidance) with respect to QBAI.

Global intangible low-taxed income (GILTI) (cont.)

Deemed-paid foreign income taxes. The Act amends current Section 960 such that a US corporation with a GILTI inclusion is treated as having paid foreign income taxes equal to 80% of the product of: (i) its "inclusion percentage" and (ii) the aggregate "tested foreign income taxes" paid or accrued by its CFCs.

A US corporation's inclusion percentage for a tax year means the ratio (expressed as a percentage) of: (i) its GILTI inclusion to (ii) the aggregate of its pro rata shares of the tested income of its CFCs. Tested foreign income taxes of a CFC means the foreign income taxes paid or accrued by the CFC that are properly attributable to the tested income of the CFC that is taken into account by the US corporation under Section 951A.

Notwithstanding that the US corporation is treated as having paid only 80% of the product determined above, the Act amends Section 78 generally to treat the US corporation as having received dividends from the relevant CFCs equal in the aggregate to 100% of that product. (The deemed dividends are not, however, treated as dividends for purposes of calculating dividend-received deductions under Section 245 or 245A.)

The Act also creates a new foreign tax credit limitation category under Section 904(d) for GILTI that does not constitute passive category income (passive GILTI continues to be treated as income in the passive limitation category). Excess foreign tax credits in the non-passive GILTI limitation category for a tax year cannot be carried back or forward to another tax year.

Effective date

The new GILTI provision is effective for tax years of foreign corporations beginning after 31 December 2017, and for tax years of US shareholders with or within which such tax years of foreign corporations end.

Deduction for foreign-derived intangible income (FDII) and GILTI

The Act allows a US corporation a new deduction in respect of its 'foreign-derived intangible income' (FDII) and GILTI inclusion (including any corresponding Section 78 dividends). For tax years of the US corporation beginning after 31 December 2017 but on or before 31 December 2025, the deduction generally equals the sum of: (i) 37.5% of the US corporation's FDII and (ii) 50% of the sum of: (a) its GILTI inclusion and (b) corresponding Section 78 dividends. If, however, the sum of the US corporation's FDII, GILTI, and Section 78 dividends exceeds its taxable income (determined without regard to the new deduction), the amount of FDII (on the one hand) and GILTI and Section 78 dividends (on the other) is reduced proportionately to eliminate the excess. For tax years beginning after 31 December 2025, the percentages described are reduced to 21.875% and 37.5%, respectively.

Foreign-derived intangible income. A US corporation's FDII for a tax year is the amount that bears the same ratio to its "deemed intangible income" as its "foreign-derived deduction-eligible income" bears to its "deduction-eligible income."

Deduction-eligible income. A US corporation's deduction-eligible income for any tax year means the excess, if any, of: (i) its gross income, without regard to any amount included in gross income under Section 951(a)(1), its GILTI inclusion, any financial services income (as defined under Section 904(d)(2)(D)), any dividend received from a CFC in respect of which it is a US shareholder, any domestic oil and gas extraction income, and any foreign branch income (as defined under new Section 904(d)(2)(J)), over (ii) the deductions, including taxes, properly allocable to such gross income.

Foreign-derived deduction-eligible income. A US corporation's foreign-derived deduction-eligible income for a tax year means any deduction-eligible income that the corporation derived in that year in connection with: (i) property sold (for these purposes, including a lease, license, exchange, or other disposition) to any non-US person that the US corporation "establishes to the satisfaction of the [Treasury] Secretary" (establishes) is for a "foreign use"; or (ii) services that the US corporation establishes that it provided to a person or, with respect to property, located outside of the US. Foreign use means any use, consumption, or disposition that is not within the US. Special rules apply to property sold or services provided to: (i) an unrelated intermediary within the US and (ii) a related party (generally defined as greater-than-50% common ownership).

Deduction for foreign-derived intangible income and GILTI (cont.)

Deemed intangible income. A US corporation's deemed intangible income for a tax year is the excess, if any, of its deduction-eligible income over its "deemed tangible income return" for the year. A US corporation's deemed tangible income return for a tax year is 10% of the corporation's QBAI for the year. QBAI is determined with reference to tangible property (or portion thereof) that a US corporation used in a trade or business for the production of deduction-eligible income and for which a deduction is generally allowable under Section 167. A US corporation's QBAI for a tax year is the average of the aggregate-adjusted bases in such property, measured as of the close of each quarter of the year.

Effective date

The new deduction is allowable for tax years beginning after 31 December 2017.

Base erosion and anti-abuse tax (BEAT)

The Act introduces a base erosion minimum tax (generally referred to as a BEAT). In general, the BEAT applies to an applicable taxpayer (i.e., corporations, other than RICs, REITs, or S-corporations) that is subject to US net income tax with average annual gross receipts of at least $500 million for the three-year period ending with the preceding tax year, and that has made certain related-party deductible payments, determined by reference to a base erosion percentage of at least 3% (2% in the case of banks and certain security dealers) of the corporation's total deductions for the year.

An applicable taxpayer is required to pay a base erosion minimum tax amount equal to the excess of 10% (5% rate applies for tax years beginning in calendar year 2018) of its modified taxable income for a tax year over its regular tax liability for the tax year reduced, but not below zero, by the excess, if any, of credits allowed under Chapter 1 against the regular tax liability over the sum of: (1) the credit allowed under Section 38 (general business credit) for the tax year properly allocable to the research credit (Section 41(a)), plus (2) the portion of the applicable Section 38 credits not in excess of 80% of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)). "Applicable Section 38 credits" means credits properly allocable to: (1) the low-income housing credit (Section 42(a)), (2) the renewable electricity production credit (Section 45(a)), and (3) the investment credit (Section 46), but only to the extent properly allocable to the energy credit determined under Section 48.

For tax years beginning after 31 December 2025, the 10% rate is increased to 12.5%, and the regular tax liability is reduced by the aggregate amount of Chapter 1 credits. In the case of a taxpayer that is a member of an affiliated group that includes a bank (Section 581) or a registered securities dealer (Section 15(a) of the Securities Exchange Act of 1934), the rates are one percentage point higher than the rates described above.

An applicable taxpayer's modified taxable income equals its taxable income determined under Chapter 1 without regard to a deduction or reduction, as applicable, (a base erosion tax benefit), allowable for the tax year with respect to any base erosion payment, and without regard to any "base erosion percentage" of any NOL deduction allowed under Section 172. Base erosion tax benefits attributable to base erosion payments that are taxed under Sections 871 or 881, in proportion to the actual rate of tax imposed under those sections to 30%, are excluded from the computation of modified taxable income.

Base erosion and anti-abuse tax (BEAT) (cont.)

A “base erosion payment” generally means: (i) any amount paid or accrued by the corporation to a foreign related party and with respect to which a deduction is allowable, including amounts paid or accrued to acquire depreciable or amortizable property, (ii) any premium or other consideration paid or accrued by the taxpayer to a foreign person that is a related party of the taxpayer for any reinsurance payments taken into account under Sections 803(a)(1)(B) or 832(b)(4)(A), and (iii) any amount that constitutes reductions in gross receipts of the taxpayer that is paid to or accrued by the taxpayer with respect to (1) a surrogate foreign corporation (as defined in Section 7874(a)(2)) that is a related party of the taxpayer (but only if such person first became a surrogate foreign corporation after 9 November 2017), and (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation.

Base erosion payments do not include: (i) any amount that constitutes reductions in gross receipts, including payments for costs of goods sold (except as noted above with respect to surrogate foreign corporations), (ii) any amount paid or accrued by a taxpayer for services if such services meet the requirements for eligibility for use of the services cost method described in Treas. Reg. Section 1.482-9, without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure and only if the payments are made for services that have no markup component, and (iii) any qualified derivative payment, if certain requirements are met.

A “base erosion tax benefit” means: (i) any deduction allowed under Chapter 1 for the tax year with respect to a base erosion payment, (ii) in the case of a base erosion payment with respect to the purchase of property of a character subject to the allowance for depreciation or amortization, any deduction allowed in Chapter 1 for depreciation or amortization with respect to the property acquired with such payment, (iii) any reduction under Section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity insurance, and any deduction under Section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the tax year for premiums paid for reinsurance, or (iv) any reduction in gross receipts with respect to a payment described above with respect to a surrogate foreign corporation in computing gross income of the taxpayer for the tax year.

Base erosion and anti-abuse tax (BEAT) (cont.)

The "base erosion percentage" for any tax year is the aggregate amount of base erosion tax benefits for the year divided by the aggregate deductions allowable under Chapter 1 for the year, including base erosion payments, though the denominator excludes deductions allowed under Sections 172, 245A or 250, and deductions for qualified derivative payments and payments for certain services outside the scope of a base erosion payment (as described above).

For purposes of the provision, all persons treated as a single employer under Section 52(a) are treated as one person. However, the exception for foreign corporations under Section 1563(b)(2)(C) is disregarded in applying Section 1563 within Section 52 for these purposes. In the case of a foreign person, the gross receipts that are taken into account for purposes of the provision are those taken into account in determining income of that foreign person that is effectively connected with the conduct of a US trade or business.

Related party for purposes of this provision means: (i) any 25% owner of the taxpayer, (ii) any person who is related to the taxpayer or any 25% owner of the taxpayer, within the meaning of Sections 267(b) or 707(b)(1), and (iii) any other person related to the taxpayer within the meaning of Section 482. Section 318 regarding constructive ownership of stock applies to the definition of related party with the exception that "10%" is substituted for "50%" in Section 318(a)(2)(C), and, for these purposes, Section 318(a)(3)(A), (B) and (C) do not cause a US person to own stock owned by a person who is not a US person.

The Act grants the Treasury Department broad authority to prescribe such regulations or other guidance necessary or appropriate, including regulations providing for such adjustments to the application of this Section necessary to prevent avoidance of the provision, including through: (1) the use of unrelated persons, conduit transactions, or other intermediaries, or (2) transactions or arrangements designed in whole or in part: (A) to characterize payments otherwise subject to this provision as payments not subject to this provision, or (B) to substitute payments not subject to this provision for payments otherwise subject to this provision.

The Act adds new information reporting requirements under Sections 6038A and 6038C to require the reporting of information relating to payments subject to the provision. Further, the Act also increases the failure to furnish information or maintain records penalties under Section 6038A(d)(1) and (2) to $25,000.

Effective date

The BEAT applies to base erosion payments paid or accrued in tax years beginning after 31 December 2017.

Denial of deduction for certain hybrid payments

The Act denies a deduction for any disqualified related-party amount paid or accrued with respect to a hybrid transaction or by, or to, a hybrid entity. A disqualified related-party amount is any interest or royalty paid or accrued to a related party (within the meaning of Section 954(b)(3)) to the extent: (1) there is no corresponding inclusion to the related party under the tax law of the country in which the party is a resident for tax purposes or is subject to tax, or (2) the related party is allowed a deduction with respect to such amount under the tax law of such country. However, the provision does not apply to interest or royalties included in the gross income of a US shareholder as subpart F income under Section 951(a). A hybrid transaction is any transaction, series of transactions, agreement, or instrument in which one or more payments are treated as interest or royalties for US tax purposes but not so treated under the tax law of the country of which the recipient of the payment is resident for tax purposes or is subject to tax. A hybrid entity is any entity that is fiscally transparent for US tax purposes but not so treated for purposes of the tax law of the country of which the entity is resident for tax purposes or is subject to tax, or vice versa.

The Act grants the Treasury broad authority to issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of the provision, including regulations or other guidance providing rules for:

1. Denying deductions for conduit arrangements that involve a hybrid transaction or a hybrid entity
2. Applying the provision to branches or domestic entities
3. Applying the provision to certain structured transactions
4. Treating a tax preference as an exclusion from income (if such preference has the effect of reducing the country's generally applicable statutory tax rate by at least 25%) for purposes of determining whether a payment of interest or a royalty is treated as a disqualified related-party amount
5. Denying all of a deduction claimed for an interest or a royalty payment if such amount is subject to a participation exemption system or other system providing for the exclusion or deduction of a substantial portion of such amount
6. Determining the tax residence of a foreign entity if the foreign entity is otherwise considered a resident of more than one country or of no country
7. Creating exceptions to the general rule set forth in the provision
8. Setting forth requirements for record-keeping and information in addition to any requirements imposed by Section 6038A

Effective date

The provision is effective for tax years beginning after 31 December 2017.

Individual tax rates

Prior rates

Rate	Married filing jointly (MFJ)	Head of Household (HoH)	Single	Estate and trust
10%	<$18.650	<$13,350	<$9,325	N/A
15%	<$75,900	<$50,800	<$37,950	<$2,550
25%	<$153,100	<$131,200	<$91,900	<$9,150
28%	<$233,350	<$212,500	<$191,650	N/A
33%	<$416,700	<$416,700	<$416,700	N/A
35%	<$470,700	<$444,500	<$418,400	<$12,500
39.6%	>$470,700	>$444,500	>$418,400	>$12,500

New rates

Rate	MFJ	HoH	Single	Estate and trust
10%	<$19,050	<$13,600	<$9,525	<$9,525
12%	<$77,400	<$51,800	<$38,700	<$38,700
22%	<$165,000	<$82,500	<$82,500	<$82,500
24%	<$315,000	<$157,500	<$157,500	<$157,500
32%	<$400,000	<$200,000	<$200,000	<$200,000
35%	<$600,000	<$500,000	<$500,000	<$300,000
37%	>$600,000	>$500,000	>$500,000	>$300,000

The Act:

- Does not phase out the benefit of the 12% bracket for taxpayers with AGI over $1 million ($1.2 million for married taxpayers filing jointly)
- Retains the prior law maximum rates on net capital gains and qualified dividends
- Simplifies the “kiddie tax” up to tax years beginning before 31 December 2025
- Directs the Treasury Secretary to promulgate due diligence requirements for paid preparers to use in determining whether a taxpayer is eligible to file as head of household

Individual alternative minimum tax

The Act temporarily increases both the exemption amount and exemption amount phase-out thresholds for the individual AMT. For tax years beginning 1 January 2018 through 31 December 2025, the AMT exemption amount is $109,400 for married taxpayers filing jointly, $54,700 for married taxpayers filing separately, and $70,300 for all other taxpayers (except trusts and estates). The phase-out threshold increases to $1 million for married taxpayers filing jointly and $500,000 for all other taxpayers, except trusts and estates.

Standard deduction

For tax years 2018 through 2025, the Act increases the standard deduction to:

- $24,000 for married couples filing jointly and surviving spouses
- $18,000 for single filers with at least one qualifying child
- $12,000 for all other taxpayers

The standard deduction will be indexed for inflation using the Chained CPI-U instead of the CPI-U.

The Act suspends the personal exemption deduction for tax years beginning 1 January 2018 through 31 December 2025. The Act also authorizes the Treasury Secretary to administer the Section 3402 withholding rules, without regard to amendments made by the provision, for tax years beginning before 1 January 2019. (Whether wage withholding rules remain unchanged for 2018 is at the Treasury's discretion.)

Child tax credit (CTC)

For tax years 2018 through 2025, the Act increases the child tax credit to $2,000 per qualifying child, but retains the age limit for a qualified child, permitting the credit to be claimed for each qualifying child who is younger than 17. It also provides, for tax years 2018 through 2025, a $500 nonrefundable credit for qualifying dependents other than qualifying children. The maximum refundable amount of the credit does not exceed $1,400 per qualifying child. The Social Security number for each qualifying child must be provided on the tax return on which a credit is claimed.

The income level at which the credit begins to phase out is $400,000 for married taxpayers filing jointly and $200,000 for all other taxpayers; these threshold amounts are not indexed for inflation.

Mortgage interest deduction

For tax years beginning 1 January 2018 through 31 December 2025, the Act allows a taxpayer to treat up to $750,000 as acquisition indebtedness ($375,000 for married taxpayers filing separately). For tax years beginning after 31 December 2025, the Act permits a taxpayer to treat up to $1 million ($500,000 for married taxpayers filing separately) as acquisition indebtedness, regardless of when the indebtedness is incurred.

The Act also eliminates the deduction for interest on home equity loans for tax years beginning 1 January 2018, through 31 December 2025, unless the loan is used to “buy, build, or substantially improve the taxpayer’s home that secures the loan.” The provision applies to mortgages entered after 15 December 2017.

This provision does not apply to mortgages entered on or before 15 December 2017 or to refinancing of such indebtedness after that date, as long as the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness.

State and local tax deduction

The Act allows an individual taxpayer to claim a deduction for state, local or foreign property or sales taxes only when the taxes were paid or accrued in carrying on a trade or business or an activity described in Section 212 (expenses incurred for the production of income). The Act generally eliminates the ability of an individual taxpayer to deduct his state or local income taxes, war profits or excess profits tax. One exception is available under the Act, allowing a taxpayer to claim an itemized deduction of up to $10,000 ($5,000 if married filing separately) for the aggregate amount of state and local property tax, war profits, excess profits tax and income tax (or sales taxes). Additionally, individuals can generally continue to deduct their distributive share of state and local property taxes allocable from a pass-through entity.

These rules apply for tax years beginning after 31 December 2017, and before 1 January 2026.

The Act provides that state or local income tax imposed for a tax year beginning after 31 December 2017, may not be prepaid and claimed as an itemized deduction for 2017. Nonetheless, the IRS has clarified that 2018 real property taxes assessed before 2018 may be deductible if paid in 2017.

Individual

Charitable contributions

The Act increases the income-based percentage limit (Section 170(b)(1)(A)) from 50% to 60% on the total charitable contribution deduction an individual taxpayer may claim for certain charitable contributions of cash to public charities. This change allows an individual taxpayer to claim a charitable contribution deduction for cash donations to charity totaling up to 60% of the taxpayer’s AGI for the year. The provision does not apply to tax years beginning after 31 December 2025.

The Act also eliminates the deduction for amounts paid for college seating rights and the exception to the contemporaneous written acknowledgement if the donee organization files a return with the required information.

Roth recharacterization as traditional IRA

The Act eliminates the ability to reverse a Roth IRA conversion by recharacterizing converted Roth IRA contributions as traditional IRA contributions.

Under the Act, the special rule allowing recharacterization of IRA contributions does not apply to a conversion contribution to a Roth IRA. As a result, recharacterization cannot not be used to reverse a Roth IRA conversion, but may be used for other contributions.

Estate, gift and generation-skipping tax

The Act doubles the estate and gift tax exemption for estates of decedents dying and gifts made from 1 January 2018 through 31 December 2025, by increasing the Section 2010(c)(3) basic exclusion amount from $5 million to $10 million, indexed for inflation occurring after 2011. The Act also authorizes the Treasury to prescribe regulations as necessary to address differences between the basic exclusion amount in effect at the time of the decedent's death and at the time of any gifts made by the decedent.