LEGAL UPDATE

PRACTICAL INSIGHTS ON TAX REFORM: U.S. AND INTERNATIONAL CORPORATIONS

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On December 22, 2017, President Trump signed into law legislation, known as the Tax Cuts and Jobs Act ("TCJA"), which is the most extensive overhaul of the United States Internal Revenue Code (the "Code") in 30 years. In December, we issued a general advisory outlining the major changes to the Code made by TCJA. This advisory focuses on the provisions of TCJA that affect corporations.

CORPORATE TAX RATE PERMANENTLY REDUCED FROM 35% TO 21%

- Corporations are now subject to a flat 21% tax rate (instead of a graduated rate of up to 35%). This provision, which does not sunset, also applies to personal service corporations.

CORPORATE ALTERNATIVE MINIMUM TAX (AMT) ELIMINATED

- As part of the business tax reform provisions, the corporate alternative minimum tax has been repealed. Moving forward, corporations with AMT credits may use the credits to offset regular tax liability for tax years beginning after December 31, 2017 – and a portion of excess credits for taxable years beginning after December 31, 2017 and before January 1, 2022 is refundable.

CAPITAL CONTRIBUTIONS AND DIVIDENDS TO CORPORATIONS

- TCJA eliminated the exclusion from tax for certain capital contributions from state and local governments.
- The dividend received deduction is still available to corporations, but at lower levels (depending on ownership of the payor company, the deduction is limited to 50% and 65% instead of 70% and 80%).

LIMITATION ON DEDUCTING INTEREST EXPENSE

- Deductions for interest expenses paid by the taxpayer are now limited to the sum of (1) business interest income; (2) 30% of the adjusted taxable income of the taxpayer; and (3) the floor plan financing interest of the taxpayer for the taxable year (generally only applicable to dealers of vehicles, boats, farm machinery, or construction machinery). Adjusted taxable income for this purpose is the taxable income of the taxpayer with the exclusion of: (1) any nonbusiness income, gain, deduction, or loss, (2) business interest and business interest income, (3) any net operating loss deduction, and (4) any deduction allowable for depreciation, amortization, or depletion.
- Disallowed amounts under the limitation are treated as business interest paid or accrued in the following tax year, and disallowed interest will have an indefinite carryforward.
- A disallowed interest carryforward will be a tax attribute that carries over in certain corporate acquisitions subject to section 381. In addition, TCJA modifies section 382 to revise the definition of pre-change loss to include any disallowed interest carryforward, which makes such carryforwards subject to the section 382 limitation in the same manner as NOL carryforwards.
- There are some key exclusions from the new interest limitations. Specifically, the interest deduction limitations don't apply to: (1) any taxpayer that has annual gross receipts under $25 million, (2) regulated public utilities, (3) an electing real property trade or business, and (4) an electing farming business.

LIMITATIONS ON NET OPERATING LOSSES (NOLS)

- The TCJA eliminated NOL carrybacks (although NOLs now have an indefinite carryforward period). NOL deductions are now limited to 80% of taxable income for a given year.

NEW RULES FOR BONUS DEPRECIATION AND FULL EXPENSING ON NEW AND USED PROPERTY

- The TCJA allows a 100% first-year deduction (from 50% under prior law) for the adjusted basis of qualifying assets placed in service after September 27, 2017, and before January 1, 2023 (phasing down in future years before expiring for taxable years beginning after December 31, 2025). The definition of "qualifying property" was expanded to include used property purchased in an arm's-length transaction.
- Taxpayers may now deduct up to $1 million under section 179 for properties placed in service beginning in 2018 (double the previous allowable amount) with an increased phase-out threshold of $2.5 million.
- ***Tax Planning Tip:*** Consider whether your business made any qualifying asset acquisitions made during the fourth quarter of 2017, as the full expensing can be taken on the 2017 return if the property was acquired and placed in service after September 27, 2017.

AVAILABILITY OF THE CASH METHOD OF ACCOUNTING EXPANDED FOR SMALL BUSINESSES

- The TCJA expanded the availability of cash method accounting for small businesses. For tax years beginning after December 31, 2017, the average annual gross receipts threshold for businesses to use the cash method increases from $5 million to $25 million.
- Under the cash method of accounting, companies do not recognize income until actually or constructively received—regardless of whether the purchase, production, or sale of merchandise is an income-producing factor.
- Small businesses who meet the $25 million gross receipts threshold are not required to account for inventories and are exempt from the uniform capitalization rules.
- The threshold for average gross receipts for exemption from uniform capitalization (UNICAP) rules increased to $25 million (from $10 million).

SIGNIFICANT CHANGES TO INTERNATIONAL TAX SYSTEM

- The TCJA requires "deemed repatriation" of certain accumulated overseas earnings. This will require U.S. shareholders who own stock in certain foreign corporations to pay a one-time deemed repatriation tax on their share of accumulated overseas earnings. The tax can be paid in installments.
- There is a new 100% dividend received deduction for domestic C corporations with respect to dividends from their foreign subsidiaries (allowing such dividends to be paid tax-free).
- Certain U.S. shareholders of controlled foreign corporations (CFCs) must include in income their share of the "global intangible low-taxed income" of such CFCs.

THIS ADVISORY WAS PREPARED BY ELIZABETH NORMAN OF NUTTER'S TAX DEPARTMENT. PLEASE STAY TUNED FOR THE NEXT ADVISORY IN OUR *PRACTICAL INSIGHTS ON TAX REFORM* SERIES. LEARN MORE ABOUT THIS LEGISLATION BY CONTACTING A MEMBER OF OUR TAX DEPARTMENT AT 617.439.2000.