# SUMMARY OF THE TAX CUTS AND JOBS ACT OF 2017

SoftwareColorado
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# QUICK FACTS



- The Act is the largest overhaul to the Internal Revenue Code since 1986.
- The Act is expected to increase the national deficit by roughly $1.5 trillion over the next decade.
- The Act was passed using the Senate budget reconciliation process in order to get through with a simple majority vote.
- Due to reconciliation rules and limitations on deficit increases, the Act required a substantial give-and-take effort calling for a number of new provisions as well as a number of repealed provisions.
- Most provisions are generally effective beginning Jan. 1, 2018.
- All of the individual tax provisions expire after 2025.
- Most business-related provisions are permanent.
- Many technical corrections and regulations to come!!!

# TIMELINE



- **Apr. 26, 2017**: White House releases roadmap for tax reform (one-page document).
- **Sep. 27, 2017**: White House releases "unified framework" for tax reform developed by the Big Six.
- **Nov. 2, 2017**: House unveils TCJA draft bill (H.R. 1).
- **Nov. 9, 2017**: House Ways and Means Committee passes bill.
- **Nov. 16, 2017**: The full House passes bill along party line vote of 227-205 (no Democratic reps vote for the bill; 13 Republicans vote against it).
- **Dec. 2, 2017**: Senate passes its own version of the bill in a 51-49 vote (no Democratic senators vote for the bill; Republican Senator Corker votes against).
- **Dec. 15, 2017**: House and Senate bills are reconciled in Conference Committee draft.
- **Dec. 19, 2017**: Conference report agreed to in House.
- **Dec. 22, 2017**: President signs the bill into law, becomes Public Law No. 115-97.

# INDIVIDUAL PROVISIONS



## *New Rate Brackets*

- The Act keeps seven brackets but lowers the tax rates beginning Jan. 1, 2018.
- The preferential rates for capital gains and qualified dividends are retained.
- The Act also retains the 3.8% net investment income tax and the 0.9% additional Medicare tax for high earners.

### *MFJ Rate Table*

| Prior Law | | TCJA | |
|---|---|---|---|
| 10% | $0 - $19,050 | 10% | $0 - $19,050 |
| 15% | $19,050 - $77,400 | 12% | $19,050 - $77,400 |
| 25% | $77,400 - $156,150 | 22% | $77,400 - $165,000 |
| 28% | $156,150 - $237,950 | 24% | $165,000 - $315,000 |
| 33% | $237,950 - $424,950 | 32% | $315,000 - $400,000 |
| 35% | $424,950 - $480,050 | 35% | $400,000 - $600,000 |
| 39.60% | $480,050+ | 37% | $600,000+ |

# INDIVIDUAL PROVISIONS



## *New Rate Brackets (continued)*

### *Single Filer Rate Table*

| Prior Law | | TCJA | |
|---|---|---|---|
| 10% | $0 - $9,525 | 10% | $0 - $9,525 |
| 15% | $9,525 - $38,700 | 12% | $9,525 - $38,700 |
| 25% | $38,700 - $93,700 | 22% | $38,700 - $82,500 |
| 28% | $93,700 - $195,450 | 24% | $82,500 - $157,500 |
| 33% | $195,450 - $424,950 | 32% | $157,500 - $200,000 |
| 35% | $424,950 - $426,700 | 35% | $200,000 - $500,000 |
| 39.6% | $426,700+ | 37% | $500,000+ |

# INDIVIDUAL PROVISIONS



## *Increased Standard Deduction*

- The standard deduction increases to:
  - $24,000 for MFJ filers (from $12,700)
  - $18,000 for head-of-household filers (from $9,350)
  - $12,000 for single filers (from $6,350)
- Additional standard deduction for blind and elderly is retained.

## *Suspension of Personal Exemptions*

- Personal exemptions are eliminated and consolidated into the increased standard deduction.

## *Repeal of Individual Mandate*

- As of Jan. 1, 2019, the individual mandate created by the Affordable Care Act is repealed permanently.

# INDIVIDUAL PROVISIONS



### *Suspension of Itemized Deduction Limitation*

- **Current Law** - The total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is limited for certain upper-income taxpayers (the so-called Pease limitation). This limitation applies on top of any other limitations applicable to such deductions. Under the Pease limitation, the otherwise allowable total amount of itemized deductions is reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount. For 2017, the threshold amount is (1) $261,500 for single individuals, (2) $313,800 for MFJ and surviving spouses, (3) $287,650 for heads of households, and (4) $156,900 for married individuals filing a separate return. The Pease limitation does not reduce itemized deductions by more than 80%.
- **New Law** - The Act suspends the limitation on itemized deductions for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026.

### *Suspension of Miscellaneous Itemized Deductions*

- The Act suspends all miscellaneous itemized deductions that are subject to the 2% floor for taxable years beginning after Dec. 31, 2017 and before Jan. 1, 2026; this includes tax preparation expenses.

# INDIVIDUAL PROVISIONS



***Mortgage Interest Deduction***

- **Current Law** - A taxpayer can deduct qualified residence interest, which includes interest paid on a mortgage secured by a principal residence or a second residence. The underlying mortgage loans can represent acquisition debt of up to $1 million ($500,000 if married filing separate), plus home equity indebtedness of up to $100,000.
- **New Law** - For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the deduction for mortgage interest is limited to underlying indebtedness of up to $750,000 ($375,000 if married filing separate) and the deduction for interest on home equity indebtedness is suspended. After Dec. 31, 2025, the prior $1 million and $500,000 limitations are restored, and the suspension for home equity indebtedness ends.
  - **Refinancing** - The $1 million/$500,000 limitations continue to apply to taxpayers who refinance existing qualified residence indebtedness that was incurred before Dec. 15, 2017, so long as the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness.

# INDIVIDUAL PROVISIONS



***State and Local Tax Deduction***

- In general, the itemized deduction for personal state and local income and property taxes is substantially limited.
- A taxpayer may claim an itemized deduction of up to $10,000 ($5,000 if married filing separate) for the aggregate of (1) state and local property taxes not paid or accrued in carrying on a trade or business or income-producing activity, and (2) state and local income taxes (or sales taxes in lieu of income taxes) paid or accrued in the tax year.
- Personal foreign real property taxes are no longer deductible.
- State and local taxes attributable to a trade or business or income-producing activity continue to be deductible without limitation.

# INDIVIDUAL PROVISIONS



### *Individual AMT*

- The individual alternative minimum tax ("AMT") is retained; however, the exemption amounts have increased as follows:
  - For MFJ filers and surviving spouses, the exemption is $109,400
  - For single taxpayers, the exemption is $70,300
  - For married filing separately, the exemption is $54,700
- Additionally, the above exemption amounts are reduced (not below zero) to an amount equal to 25% of the amount by which the alternative minimum taxable income of the taxpayer exceeds the phase-out amounts, increased as follows:
  - For joint returns and surviving spouses, $1 million
  - For all other taxpayers (other than estates and trusts), $500,000
  - For trusts and estates, the base figure of $22,500 and phase-out amount of $75,000 remain unchanged
  - All of these amounts will be adjusted for inflation after 2018 under the new C-CPI-U inflation measure

# INDIVIDUAL PROVISIONS



***Child Tax Credit***

- The child tax credit ("CTC") is increased from $1,000 per child to $2,000 per child.
- Additionally, a non-refundable credit of $500 is allowed for each dependent who is not a "qualified child."
- The earned income threshold for the refundable portion of the child tax credit is lowered from $3,000 to $2,500.
- Refundable portion of the CTC is limited to $1,400 (indexed for inflation after 2018).
    - Maximum refundable credit is limited to 15% of earned income above $2,500 (previously $3,000).
- CTC is reduced by $50 for every $1,000 of AGI over specified thresholds.
- The phase-out thresholds are increased to $400,000 for MFJ filers (previously $110,000) and to $200,000 for other filers (previously $75,000).

# PASS-THROUGH PROVISIONS



## *Deduction for Pass-Through Income*

- For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the Act adds Sec. 199A, under which a noncorporate taxpayer (including a trust or estate) that has **qualified business income** ("QBI") from a partnership, S corporation, or sole proprietorship is allowed to deduct:
  - the lesser of: (a) the "combined qualified business income amount" of the taxpayer, or (b) 20% of the excess, if any, of the taxable income of the taxpayer for the tax year over the sum of net capital gain and the aggregate amount of the qualified cooperative dividends of the taxpayer for the tax year plus
  - the lesser of: (a) 20% of the aggregate amount of the qualified cooperative dividends of the taxpayer for the tax year or (b) taxable income (reduced by the net capital gain) of the taxpayer for the tax year.
- The "combined qualified business income amount" means, for any tax year, an amount equal to:
  - the deductible amount for each qualified trade or business of the taxpayer (defined as 20% of the taxpayer's QBI subject to the W-2 wage limit) plus
  - 20% of the aggregate amount of qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the tax year.

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# PASS-THROUGH PROVISIONS



***Deduction for Pass-Through Income (continued)***

- QBI is generally defined as the net amount of “qualified items of income, gain, deduction, and loss” relating to any qualified trade or business of the taxpayer.
- For this purpose, qualified items of income, gain, deduction, and loss are items of income, gain, deduction, and loss to the extent these items are effectively connected with the conduct of a trade or business within the U.S. under Sec. 864(c) and included or allowed in determining taxable income for the year.
- If the net amount of qualified income, gain, deduction, and loss relating to qualified trade or businesses of the taxpayer for any tax year is less than zero, the amount is treated as a loss from a qualified trade or business in the succeeding tax year.
- QBI does not include certain investment items, reasonable compensation paid to the taxpayer by any qualified trade or business for services rendered with respect to the trade or business, any guaranteed payment to a partner for services to the business under Sec. 707(c), or a payment under Code Sec. 707(a) to a partner for services rendered with respect to the trade or business.
- The 20% deduction is allowed as a reduction to taxable income.

# PASS-THROUGH PROVISIONS



***Deduction for Pass-Through Income (continued)***

- The deduction cannot exceed the greater of:
  - 50% of the W-2 wages with respect to the qualified trade or business or
  - the sum of 25% of the W-2 wages paid with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property.
    - "Qualified property" means tangible, depreciable property that is held by (and available for use in) the qualified trade or business at the close of the tax year, which is used at any point during the tax year in the production of qualified business income, and the depreciable period for which has not ended before the close of the tax year.
- The limit above does not apply to taxpayers with taxable income below a threshold amount, which is $315,000 for MFJ filers and $157,500 for other individuals (limit is indexed for inflation after 2018).
- The limit is phased in for individuals with taxable income exceeding the threshold amount, over the next $100,000 of taxable income for married individuals filing jointly ($50,000 for other individuals). For 2018, the limit fully applies MFJ taxpayers with taxable income over $415,000 and other individuals with taxable income over $207,500.

# PASS-THROUGH PROVISIONS



***Deduction for Pass-Through Income (continued)***

- For a partnership or S corporation, each partner or shareholder is treated as having W-2 wages for the tax year in an amount equal to their allocable share of the W-2 wages of the entity for the tax year.
- A partner or shareholder's allocable share of W-2 wages is determined in the same way as the partner's or shareholder's allocable share of wage expenses. For an S corporation, an allocable share is the shareholder's pro rata share of an item.
- A qualified trade or business means any trade or business other than a specified service trade or business.
- A **specified service trade or business** is one involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset is the reputation or skill of one or more employees. **NOTE - the definition excludes engineering and architecture firms.**
- The exclusion for specified service businesses does not apply for taxpayers with taxpayer income below the threshold amount (discussed above).
- The deduction does not apply to the trade or business of being an employee.

# PASS-THROUGH PROVISIONS



## *New Holding Period for Carried Interests*

- Carried interests have historically been taxed in the hands of the fund managers at favorable capital gain rates instead of ordinary income rates.
- For tax years beginning after Dec. 31, 2017, the Act imposes a three-year holding period requirement in order for certain partnership interests received in connection with the performance of services to be taxed as long-term capital gain.
- If the three-year holding period is not satisfied, the taxpayer's gain will be treated as short-term gain taxed at ordinary income rates.

# PASS-THROUGH PROVISIONS



***Repeal of Partnership Technical Terminations***

- **Current Law** - Under Sec. 708(b)(1)(B), a partnership would terminate if within any 12-month period there was a sale or exchange of 50% or more of the total interest in partnership capital and profits. In such a situation, it was treated as if there was a deemed contribution of all the partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners.
- **New Law** - For partnership tax years beginning after Dec. 31, 2017, partnership technical terminations are completely repealed.
    - NOTE - the Act does not alter Sec. 708(b)(1)(A), which provides for the termination of a partnership if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

# COST RECOVERY



## *Bonus Depreciation*

### Current Law

- Taxpayers receive an additional depreciation deduction in the year in which it places certain "qualified property" in service (bonus depreciation), effective for property placed in service through 2019 (2020 for certain qualified property with a longer production period). The amount of bonus depreciation is 50% of the cost of such property placed in service during 2017 and phases down to 40% in 2018 and 30% in 2019. Qualified property that is eligible for bonus depreciation is tangible personal property with a recovery period of 20 years or less under MACRS, certain off-the-shelf computer software, water utility property, and qualified improvement property.
- To be eligible for bonus depreciation, the original use of the property must begin with the taxpayer.

# COST RECOVERY



## *Bonus Depreciation (continued)*

**New Law**

- The Act extends the availability of bonus depreciation for qualified property and specified fruit- and nut-bearing plants for three additional years and increases the bonus depreciation percentage to 100%, effectively allowing taxpayers to deduct immediately the full cost of qualified property acquired and placed in service (and specified plants planted or grafted) after Se. 27, 2017 and before Jan. 1, 2023 (Jan. 1, 2024 for longer production period property).
- The Act begins to phase down the percentage that may be expensed for property placed in service after Jan. 1, 2023, as follows:
  - For property placed in service after Dec. 31, 2022 and before Jan. 1, 2024: 80% expensing.
  - For property placed in service after Dec. 31, 2023 and before Jan. 1, 2025: 60% expensing.
  - For property placed in service after Dec. 31, 2024 and before Jan. 1, 2026: 40% expensing.
  - For property placed in service after Dec. 31, 2025 and before Jan. 1, 2027: 20% expensing.

# COST RECOVERY



## *Bonus Depreciation (continued)*

- For property with longer production periods placed in service after Dec. 31, 2023 and before Jan. 1, 2025: 80% expensing.
  - For such property place in service after Dec. 31, 2024 and before Jan. 1, 2026: 60% expensing.
  - For such property placed in service after Dec. 31, 2025 and before Jan. 1, 2027: 40% expensing.
  - For such property placed in service after Dec. 31, 2026 and before Jan. 1, 2028: 20% expensing.
- For plants planted or grafted after Dec. 31, 2022 and before Jan. 1, 2024: 80% expensing.
- For plants planted or grafted after Dec. 31, 2023 and before Jan. 1, 2025: 60% expensing.
- For plants planted or grafted after Dec. 31, 2024 and before Jan. 1, 2026: 40% expensing.
- For plants planted or grafted after Dec. 31, 2025, and before Jan. 1, 2027: 20% expensing.

- Alternatively, the Act allows taxpayers to elect 50% in lieu of 100% expensing for qualified property placed in service during the first tax year beginning after Sept. 27, 2017.

# COST RECOVERY



***Bonus Depreciation (continued)***

- The New Law phase-down bonus depreciation percentage still applies to qualified property acquired by the taxpayer before Sep. 28, 2017 and placed in service by the taxpayer after Sep. 27, 2017 as well as the present-law phase-down of the Sec. 280F increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles acquired before Sep. 28, 2017 and placed service after Sep. 27, 2017.
- **The definition of qualified property now includes used property acquired by the taxpayer to be eligible for bonus depreciation, provided the property was not used by the taxpayer before the taxpayer acquired it.**
- The definition of qualified property is also amended to exclude property used in a real estate trade or business and certain regulated public utility property.
- The Act also amends the definition of qualified property to exclude any property used in a trade or business that had floor plan financing indebtedness that was taken into account in the business interest deduction limitation.

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# COST RECOVERY



***Section 179 Expensing***

**Current Law**

- A taxpayer may elect under Sec. 179 to deduct the cost of qualifying property, rather than to recover such costs through depreciation deductions.
- Under pre-Act law, the maximum amount a taxpayer could expense was $500,000 of the cost of qualifying property placed in service for the tax year. The $500,000 amount was reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the tax year exceeds $2 million. These amounts were indexed for inflation.
- In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business, and includes off-the-shelf computer software and qualified real property (e.g., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

# COST RECOVERY



***Section 179 Expensing (continued)***

**New Law**

- For property placed in service in tax years beginning after Dec. 31, 2017, the maximum amount a taxpayer may expense under Sec. 179 is **increased to $1 million**, and the **phase-out threshold amount is increased to $2.5 million**.
- For tax years beginning after 2018, these amounts are indexed for inflation.
- Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.
- The definition of Sec. 179 property is expanded to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging. The definition of "qualified real property" eligible for Sec. 179 expensing is also expanded to include the following improvements to nonresidential real property after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

# BUSINESS TAX PROVISIONS



***New Corporate Rate***

- **Current Law** - C corporations pay graduated federal rates of 15%, 25%, 34%, and 35%. Personal service corporations pay a flat 35% rate. Top rate kicks in at $10 million of taxable income.
- **New Law** - Effective Jan. 1, 2018, the corporate rate is a flat 21%, which also applies to personal service corporations.
  - NOTE - due to the Jan. 1, 2018 effective date, fiscal year taxpayers will be required to use the blended rate provisions of Sec. 15.

***Dividends Received Deduction***

- **Current Law** - Corporations that receive dividends from other corporations are entitled to a deduction for dividends received. If the corporation owns at least 20% of the stock of the corporation, an 80% dividends received deduction ("DRD") is allowed. Otherwise, a 70% deduction is allowed.
- **New Law** - For tax years beginning after Dec. 31, 2017, the 80% DRD is reduced to 65%, and the 70% DRD is reduced to 50%.

***Corporate AMT***

- For tax years beginning on or after Jan. 1, 2018, the corporate AMT is repealed.

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# BUSINESS TAX PROVISIONS



## *Deduction Limitation for Business Interest*

### Current Law

- Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations.
- For a taxpayer other than a corporation, the deduction for interest on indebtedness that is allocable to property held for investment (investment interest) is limited to the taxpayer's net investment income for the tax year.
- Sec. 163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a tax year if: (1) the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio); and (2) the payor's net interest expense exceeds 50% of its adjusted taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, the Sec. 199 deduction, depreciation, amortization, and depletion).

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# BUSINESS TAX PROVISIONS



## *Deduction Limitation for Business Interest (continued)*

**New Law**

- For tax years beginning after Dec. 31, 2017, every business is generally subject to a disallowance of a deduction for net interest expense in excess of **30% of the business's adjusted taxable income**.
- The net interest expense disallowance is determined at the tax filer level. However, a special rule applies to pass-through entities.
- For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion.
- The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward indefinitely, subject to certain restrictions applicable to partnerships (see below).

# BUSINESS TAX PROVISIONS



***Deduction Limitation for Business Interest (continued)***

- An exemption from the limitation rules applies for taxpayers with average annual gross receipts for the three-tax-year period ending with the prior tax year that do not exceed $25 million.
- Real property trades or businesses can elect out of the provision if they use ADS to depreciate applicable real property used in a trade or business.

# BUSINESS TAX PROVISIONS

## *Changes to the NOL Deduction*

### Current Law

- A net operating loss ("NOL") may generally be carried back two years and carried forward 20 years.
- Some exceptions apply for certain NOL carrybacks (e.g., disaster losses).

### New Law

- For NOLs arising in tax years ending after Dec. 31, 2017, **the carryforward period is indefinite**.
- The two-year carryback and the special carryback provisions are repealed.
  - A two-year carryback applies in the case of certain losses incurred in the trade or business of farming.
- Additionally, for losses arising in tax years beginning after Dec. 31, 2017, the NOL deduction is limited to 80% of taxable income (determined without regard to the deduction).
- NOLs of property and casualty insurance companies can be carried back two years and carried over 20 years to offset 100% of taxable income in such years.

# BUSINESS TAX PROVISIONS



***Section 199 Deduction Repealed***

- For tax years beginning after Dec. 31, 2017, the domestic production activities deduction under Sec. 199 is repealed.

***Like-Kind Exchange Property Limited to Real Property***

- Generally effective for transfers after Dec. 31, 2017, the rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges **only with respect to real property** that is not held primarily for sale.
- However, under a transitional rule, previous like-kind exchange rules apply to exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before Dec. 31, 2017.

***Entertainment Expenses Disallowed***

- For amounts paid or incurred after Dec. 31, 2017, **deductions for entertainment expenses are disallowed**.

***Business Meals***

- For amounts paid or incurred after Dec. 31, 2017, the current 50% limit on the deductibility of business meals is expanded to include meals provided through an in-house cafeteria or otherwise on the premises of the employer.

# BUSINESS TAX PROVISIONS



***Certain Fringe Benefit Expenses Limited***

- Deductions for employee transportation fringe benefits (e.g., parking and mass transit) are denied, but the exclusion from income for such benefits received by an employee is retained.
- Also, no deduction is allowed for transportation expenses that are the equivalent of commuting for employees (e.g., between the employee's home and the workplace), except as provided for the safety of the employee.
- For tax years beginning after Dec. 31, 2025, the Act will disallow an employer's deduction for expenses associated with meals provided for the convenience of the employer on the employer's business premises, or provided on or near the employer's business premises through an employer-operated facility that meets certain requirements.

# BUSINESS TAX PROVISIONS



## *Five-Year Amortization for R&E Expenses*

### Current Law

- Under Sec. 174, taxpayers can elect to fully deduct their research and experimentation ("R&E") expenses each year.

### New Law

- For amounts paid or incurred in tax years beginning after Dec. 31, 2021, **R&E costs must be capitalized and amortized ratably over a five-year period** (15 years if the R&E is conducted outside of the U.S.), beginning with the midpoint of the tax year in which the specified R&E expenses were paid or incurred.
- Use of this provision is treated as a change in the taxpayer's accounting method. For R&E expenses paid or incurred in tax years beginning after Dec. 31, 2025, the provision is applied on a cutoff basis (i.e., no adjustment under Sec. 481(a) required).

## *R&E Tax Credit*

- The R&E tax credit under Sec. 41 remains fully in effect under the Act and is generally not impacted by the change in R&E expensing above.

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# BUSINESS TAX PROVISIONS



***Credit for Employer-Paid Family and Medical Leave***

- The Act creates a new credit for wages paid in tax years beginning after Dec. 31, 2017 (but not beginning after Dec. 31, 2019) equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment is 50% of the wages normally paid to an employee.
- The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.
- To qualify for the credit, all qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave (all less-than-full-time qualifying employees have to be given a commensurate amount of leave on a pro rata basis).

# BUSINESS TAX PROVISIONS



## *New Provisions for Compensation*

- **Changes to Sec. 162(m)**
  - **Current Law** - Under Sec. 162(m), a deduction for compensation paid or accrued with respect to a “covered employee” of a publicly traded corporation is limited to no more than $1 million per year. However, exceptions apply for: (1) commissions; (2) performance-based remuneration, including stock options; (3) payments to a tax-qualified retirement plan; and (4) amounts that are excludable from the executive's gross income.
  - **New Law** - For tax years beginning after Dec. 31, 2017, the exceptions to the $1 million deduction limitation for commissions and performance-based compensation are repealed. The definition of “covered employee” is revised to include the principal executive officer, the principal financial officer, and the three other highest-paid officers. If an individual is a covered employee with respect to a corporation for a tax year beginning after Dec. 31, 2016, the individual remains a covered employee for all future years. Definition of covered company expanded to include private companies with publicly traded debt.
- **Sec. 83(i)** - Option and RSU holders have the ability to defer taxable income on exercise or vesting, respectively, for up to five years. However, there are significant restrictions: (1) the company must have granted options with identical terms to at least 80% of its full-time employees and (2) no 1% shareholder, CEO, CFO, or top-four executive thereafter may utilize this deferral. Thus, this provision effectively applies only to those companies with a broad-based equity program.

# ACCOUNTING METHOD PROVISIONS



***New Gross Receipts Test for Cash Method***

**Current Law**

- Corporations and partnerships (with a corporate partner) may only use the cash method of accounting if its average gross receipts do not exceed $5 million for the prior three taxable years.

**New Law**

- For tax years beginning after Dec. 31, 2017, the gross receipts test is increased to $25 million, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor.
- NOTE - The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations are retained. Therefore, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of the method clearly reflects income.
- The new gross receipts test will be considered a change in a taxpayer's method of accounting.

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# ACCOUNTING METHOD PROVISIONS



***Year of Income Inclusion***

**Current Law**

- In general, cash-basis taxpayers include an amount in income when such amount is actually or constructively received. For an accrual-basis taxpayer, an amount is generally included in income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (i.e., the all events test).
- A number of exceptions permit taxpayers to defer income related to advance payments. An advance payment occurs when the taxpayer receives payment before the provision of the related goods or services to its customer.

**New Law**

- For tax years beginning after Dec. 31, 2017, a taxpayer is required to recognize income no later than the tax year in which such income is taken into account on an applicable financial statement (subject to an exception for long-term contracts under Sec. 460).

# ACCOUNTING METHOD PROVISIONS



***Year of Income Inclusion (continued)***

- The Act further codifies the deferral method for advance payments under Rev. Proc. 2004-34, allowing taxpayers to defer income arising from certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.
- Changes in accounting method necessitated by these revisions will be made on an automatic basis.

# INTERNATIONAL TAX PROVISIONS



***Mandatory Repatriation ("Toll Charge")***

- Under the Act, modified Sec. 965 provides that U.S. shareholders owning at least 10% of a foreign subsidiary generally must include in income, for the subsidiary's last tax year beginning before 2018, the shareholder's pro rata share of the accumulated post-1986 historical earnings and profits ("E&P") of the foreign subsidiary as of the "measurement date" to the extent such E&P has not been previously subject to U.S. tax.
- The "measurement date" is either Nov. 2, 2017 or Dec. 31, 2017, whichever date produces a greater result.
- The portion of the E&P comprising cash or cash equivalents is taxed at a reduced rate of 15.5%, while remaining E&P is taxed at a reduced rate of 8%.
- The U.S. shareholder may elect to pay the tax liability over a period of up to eight years.
  - The payments for each of the first five years equal 8% of the net tax liability. The amount of the sixth installment is 15% of the net tax liability, increasing to 20% for the seventh installment and the remaining balance of 25% in the eighth year.

# INTERNATIONAL TAX PROVISIONS



***Foreign-Sourced Dividend Exemption***

- Under the Act, for tax years of foreign corporations beginning after Dec. 31, 2017 (and for tax years of U.S. shareholders in which such tax years of foreign corporations end), the current system of taxing U.S. corporations on the foreign earnings of their foreign subsidiaries when these earnings are distributed is drastically modified.
- New Sec. 245A provides for an exemption by means of a 100% deduction for the "foreign-source portion" of dividends received from specified 10%-owned foreign corporations (i.e., any foreign corporation other than a passive foreign investment company that is not also a controlled foreign corporation, with respect to which any domestic corporation is a U.S. shareholder) by domestic corporations that are U.S. shareholders of those foreign corporations within the meaning of Sec. 951(b).
- The foreign-source portion of a dividend from a specified 10%-owned foreign corporation is the amount that bears the ratio to the dividend as the undistributed foreign earnings of the specified 10%-owned foreign corporation bears to the total undistributed earnings of such foreign corporation.
- No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD.
- The DRD is available only to C corporations that are not regulated investment companies or real estate investment trusts.

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# INTERNATIONAL TAX PROVISIONS

***Transfers Involving 10%-Owned Foreign Corporations***

- Under current law, when a U.S. corporation sells or exchanges stock in a foreign subsidiary, the gain may be considered a dividend to the extent the foreign corporation has E&P that have not already been subject to U.S. tax. If foreign business is conducted through a branch of a U.S. corporation rather than a foreign subsidiary, the corporation owes U.S. taxes on the foreign earnings and deducts losses as though they accrued directly to the U.S. corporation.
- Under the Act, for sales or transfers by a domestic corporation occurring after Dec. 31, 2017 of stock in a foreign corporation held for one year or more, any amount received by the domestic corporation that is treated as a dividend for purposes of Sec. 1248 is treated as a dividend for purposes of new Sec. 245A (described above). In other words, such sale can qualify for the DRD described above.
- For dividends received in tax years that begin after Dec. 31 2017, a domestic corporate shareholder's adjusted basis in the stock of a specified 10%-owned foreign corporation is reduced by an amount equal to the portion of any dividend received with respect to such stock from such foreign corporation that was not taxed by reason of a DRD under Sec. 245A in any tax year of such domestic corporation, but only for purposes of determining loss on sales and exchanges of the foreign corporation's stock.

# INTERNATIONAL TAX PROVISIONS



***Global Intangible Low-Taxed Income ("GILTI")***

- For tax years of foreign corporations that begin after Dec. 31, 2017 (and for tax years of U.S. shareholders in which such tax years of foreign corporations end), new Sec. 951A provides that a U.S. shareholder of any controlled foreign corporation ("CFC") has to include in gross income its GILTI.
- GILTI generally means the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return.
    - Net CFC tested income means the excess of the aggregate of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder over the aggregate of its pro rata share of the tested loss of each CFC with respect to which it is a U.S. shareholder.
    - The shareholder's net deemed tangible income return is an amount equal to the excess of (1) 10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder over (2) the amount of interest expense taken into account under Sec. 951A(c)(2)(A)(ii) in determining the shareholder's net CFC tested income for the tax year to the extent the interest income attributable to the expense is not taken into account in determining the shareholder's net CFC tested income.

# INTERNATIONAL TAX PROVISIONS



***Global Intangible Low-Taxed Income ("GILTI") (continued)***

- GILTI does not include effectively connected income, subpart F income, foreign oil and gas income, or certain related party payments.
- GILTI is taxed at a flat 10% rate.
- Although foreign tax credits are allowed for foreign income taxes paid with respect to GILTI, such credits are limited to 80% of the foreign income taxes paid and are not allowed to be carried back or forward to other tax years.

# INTERNATIONAL TAX PROVISIONS



***Deduction for FDII and GILTI***

- Under new Sec. 250, for tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, a deduction is allowed for C corporations (other than a RIC or REIT) in an amount equal to the sum of: (1) 37.5% of the foreign-derived intangible income ("FDII") of the domestic corporation for the tax year, plus (2) 50% of the GILTI amount (if any), which is included in the gross income of the domestic corporation under Sec. 951A for the tax year.
- FDII of a domestic corporation is the amount that bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction-eligible income bears to its deduction-eligible income.
- For tax years that begin after Dec. 31, 2025, the allowed deduction is reduced to (1) 21.875% of the FDII of the domestic corporation for the tax year, and (ii) 37.5% of the GILTI amount included in the gross income.

# INTERNATIONAL TAX PROVISIONS



### *Changes to CFC Attribution*

- Under the Act, for the last tax year of a foreign corporation that begins before Jan. 1, 2018, for all subsequent tax years of a foreign corporation, and for the tax years of a U.S. shareholder with which such tax years end, the constructive ownership rules are modified such that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC.

### *U.S. Shareholder Definition*

- Under the Act, for the last tax year of foreign corporations beginning before Jan. 1, 2018, and for tax years of U.S. shareholders with which such tax years of foreign corporations end, the definition of "U.S. shareholder" is expanded to also include any U.S. person that owns 10% or more of the total value of shares of all classes of stock of a foreign corporation.

### *Repeal of 30-Day CFC Holding Period*

- For tax years of foreign corporations that begin after Dec. 31, 2017, and for tax years of U.S. shareholders in which such tax years of foreign subsidiaries end, a U.S. parent is subject to current U.S. tax on the CFC's subpart F income even if the U.S. parent does not own stock in the CFC for an uninterrupted period of 30 days or more during the year.

# INTERNATIONAL TAX PROVISIONS



## *No Deduction for Certain Interest and Royalty Payments*

- For tax years beginning after Dec. 31, 2017, the Act disallows a deduction for any **disqualified related party amount** paid or accrued pursuant 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 to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country.
- A **hybrid transaction** is one that involves payments of interest or royalties that are not treated as such by the country of residence of the foreign recipient.
- A **hybrid entity** is an entity that is treated as fiscally transparent for federal income purposes but not so treated for purposes of the tax law of the foreign country, or vice versa.

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# INTERNATIONAL TAX PROVISIONS

## *Base Erosion and Anti-Abuse Tax ("BEAT")*

### Current Law

- Generally, a U.S. parent corporation is subject to U.S. tax on its worldwide income, while foreign earnings are subject to U.S. tax only when repatriated to the U.S. parent.
- This regime incentivizes U.S. companies to shift income away from the U.S. to lower-tax jurisdictions (e.g., Ireland, Luxembourg) and to defer the repatriation of active foreign source earnings, sometimes permanently.
- Companies have spent enormous amounts on legal and accounting fees to develop structures designed to take advantage of the system, including cross-border payments of royalties, interest, or management fees.
- Although a withholding tax may apply to these cross-border payments, international treaties oftentimes reduce the withholding tax rate (sometimes down to 0%).

# INTERNATIONAL TAX PROVISIONS

## *Base Erosion and Anti-Abuse Tax ("BEAT") (continued)*

### New Law

- Under the Act, **base erosion payments** paid or accrued in tax years beginning after Dec. 31, 2017 by an "applicable taxpayer" are now subject to the BEAT under new Sec. 59A. The BEAT equals the "base erosion minimum tax amount" for the tax year (defined below).
- **Applicable taxpayers** are corporations (other than RICs, REITs, and S corporations) with average annual gross receipts of at least $500 million for the previous three tax years and a "base erosion percentage" of at least 3% (2% for certain banks and securities dealers).
- The **base erosion percentage** is equal to the aggregate amount of base erosion tax benefits of the taxpayer for the tax year divided by the aggregate amount of specified deductions allowable to the taxpayer for the tax year.
- A **base erosion payment** generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation.

# INTERNATIONAL TAX PROVISIONS



## *Base Erosion and Anti-Abuse Tax ("BEAT") (continued)*

- The **base erosion minimum tax amount** means the excess of 10% of the taxpayer's modified taxable income (5% in tax years beginning in calendar year 2018) over its regular tax liability as defined in Sec. 26(b), reduced (but not below zero) by:
  - Any excess of the credits allowed against the taxpayer's regular tax liability over the sum of (1) the credit allowed under Sec. 38 (the general business credit) for the tax year properly allocable to the research credit Sec. 41, plus (2) the portion of its applicable regular tax liability credits ("applicable Section 38 credits") not in excess of 80% of the lesser of (a) the applicable Section 38 credits amount or (b) the base erosion minimum tax amount determined without this adjustment.
  - "Applicable Section 38 credits" means the credit allowed under Sec. 38 allocable to the low-income housing credit under Sec. 42, the production credit under Sec. 45, and the investment credit under Sec. 46, but only to the extent properly allocable to the energy credit under Code Sec. 48.
- For tax years beginning after Dec. 31, 2025, the tax is 12.5% of the modified taxable income of the taxpayer for the tax year over an amount equal to the regular tax liability of the taxpayer for the tax year.

# INTERNATIONAL TAX PROVISIONS



***Base Erosion and Anti-Abuse Tax ("BEAT") (continued)***

- Modified taxable income means the taxable income of the taxpayer computed under Chapter 1 for the tax year, determined without regard to any base erosion tax benefit with respect to any base erosion payment, or the base erosion percentage of any NOL deduction.
- Members of affiliated groups that include a bank or securities dealer will pay the BEAT at an 11% rate (6% for tax years beginning in 2018), increasing to 13.5% after 2025.
- The Act excludes amounts paid or incurred for services if such services meet the requirements for the services cost method under Sec. 482 and if such amount is the total services cost with no markup.

# HAPPY TAX PLANNING!!