ANDERSEN TAX

SENATE TAX REFORM PROPOSAL – CORPORATE & BUSINESS

The following chart sets forth some of the provisions affecting businesses in the Senate's version of the Tax Cuts and Jobs Act, as approved by the Senate on December 2, 2017. This chart highlights only some of the key issues and is not intended to address all aspects of the proposed legislation. If you have any questions, please contact your Andersen Tax advisor.

As of December 2, 2017

U.S. CORPORATE AND BUSINESS PROVISIONS[1]		
Provision	**Description of Proposed Change**	**Comments**
C Corporation Business Income Tax Rates	The regular corporate tax rate would be lowered to a flat 20% rate (the special tax rate for personal services corporations would be eliminated) for tax years beginning after December 31, 2018. In order to preserve current tax rates on dividend income, the dividends-received deduction (DRD) is reduced to 65% and 50% (from 80% and 70%, respectively).	The one-year delay to 2019 is a key difference from the House bill, which would be effective for 2018. Corporate taxpayers should focus on accounting method changes to accelerate deductions and defer taxable income in advance of a rate reduction. Fiscal year corporations would need to calculate a prorated tax liability.
Pass-Through Business Income Tax Rates	An individual taxpayer would be allowed to deduct 23% of qualified business income from a partnership, S corporation, or sole proprietorship that is effectively connected with a U.S. trade or business. Qualified business income does not include reasonable compensation or guaranteed payment paid to the taxpayer for services. The amount of the deduction is generally limited to 50% of the taxpayer's allocable share of W-2 wages. The W-2 wage limit will not apply to a taxpayer with taxable income not exceeding $500,000 for married filing jointly (MFJ) taxpayers or $250,000 for all other individual taxpayers. The W-2 limit is then phased in over the next $100,000 of taxable income for MFJ taxpayers or $50,000 for all other individual taxpayers. The 23% deduction would generally not apply to specified service businesses, unless the taxpayer's taxable income is less than $500,000 for MFJ taxpayers or less than $250,000 for all other taxpayers. The benefit of the deduction for service businesses is then phased out over the next $100,000 of taxable income for MFJ taxpayers or $50,000 for all other taxpayers. The deduction does not apply to trusts and estates. The deduction would be effective for taxable years beginning after December 31, 2017. The deduction would expire after 2025.	In lieu of a change in tax rates, a deduction would be allowed for a portion of qualified business income from pass-through entities, similar to the present law domestic production activities deduction under Sec. 199. With a proposed top individual rate of 38.5%, this provision would approximate a top rate of 29.645% for qualifying income, which is substantially higher than the 25% special rate for qualifying pass-through businesses as proposed in the House bill. The limitation of the deduction to 50% of W-2 wages may be a significant limiter depending on the taxpayer's industry and structure. Also, service businesses would generally not receive any deduction once the $600,000 (MFJ) and $300,000 thresholds are surpassed and the deduction is phased out. The exclusion of trusts would limit many family held businesses from benefiting from the deduction. However, grantor trusts that are taxed as individuals would not be excluded. Dividends from a REIT will be considered qualified items of income. Qualified publicly traded partnership income is also qualified income, a clarification from the original Senate proposal.

[1] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

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U.S. CORPORATE AND BUSINESS PROVISIONS[2]		
Provision	**Description of Proposed Change**	**Comments**
Domestic Production Activities Deduction (DPAD)	The deduction for income attributable to domestic production activities would be repealed for taxable years beginning after December 31, 2018. The deduction for non-corporate taxpayers would be effect for taxable years beginning after December 31, 2017.	The repeal is delayed one year as compared to the House bill to align with the one-year delay in the corporate tax rate reduction.
Alternative Minimum Tax	The corporate alternative minimum tax (AMT) would be retained.	The proposal to repeal the corporate AMT was not included in the Senate bill that passed the Senate.
Revenue Recognition	Accrual method taxpayers would be required to recognize income no later than the taxable year in which it is taken into account on their applicable financial statements. The one-year deferral rule for advance payments under Rev. Proc. 2004-34 would be codified. Revenue recognition rules under Sec. 451 would be applied before the original issue discount (OID) rules under Sec. 1272.	A requirement to recognize income no later than it is recognized for book purposes may have a significant impact for taxpayers in the software, pharmaceutical, or other industries where book recognition of unbilled revenue is being accelerated in connection with the implementation of Accounting Standards Codification (ASC) 606, required in 2018 for public entities and in 2019 for private entities.
Accounting Methods for Small Businesses	Cash Method – The bill provides for a $15 million average gross receipts threshold beginning in 2018 (increase from $5 million) for corporations and partnerships with corporate partners for use of the cash method of accounting under Sec. 448. The threshold would be indexed for inflation. The business must satisfy the requirement for the prior three years. UNICAP exemption – The same business entities would be exempt from UNICAP for real and personal property acquired or manufactured, even for taxpayers where inventory is a material income producing factor in the business. Long-term Contracts – A $15 million average gross receipts threshold would apply for purposes of the exception to the requirement to use the percentage-of-completion accounting method for long-term contracts (increased from $10 million) for tax years beginning in 2018. Expensing – The limitation for small business expensing of depreciable assets under Sec. 179 would be increased to $1 million and the phase-out amount would be increased to $2.5 million effective for tax years beginning after December 31, 2017. Eligible property would be expanded somewhat.	These provisions may help smaller taxpayers reduce the overall costs and administrative burdens related to tax compliance. The cash method provision would not restrict the ability of taxpayers not subject to Sec. 448 to use the cash method of accounting (i.e., S corporations and partnerships eligible to use the cash method of accounting under present law are not restricted under the bill).

[2] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

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SENATE TAX REFORM PROPOSAL – CORPORATE & BUSINESS

U.S. CORPORATE AND BUSINESS PROVISIONS[3]

Provision	Description of Proposed Change	Comments
Cost Recovery / Increased Expensing	Expensing of 100% of the cost of new investments in qualified depreciable assets acquired and placed in service after September 27, 2017 and before January 1, 2023. The expensing would phase out between 2023 and 2026 with 80% in 2023, 60% in 2024, 40% in 2025 and 20% in 2026. An additional year would be available for certain qualified property with a longer production period. The provision continues to be limited to original-use (new) property, in contrast to the House bill which would eliminate the original-use requirement for unrelated party transactions. Qualified property would not include any property used by a regulated public utility company or in a real property trade or business. Qualified property would be expanded to include qualified films, television and live theatrical productions (property covered under present law Sec. 181) The modification to the Senate proposal expands the definition of qualified property to include qualified film, television and live theatrical productions effective for productions placed in service after September 27, 2017 and before January 1, 2023. The election to use AMT credits in lieu of accelerated depreciation would be repealed. The repeal of the election would be effective for tax years beginning after December 31, 2017.	The effective date of September 27, 2017 for the expensing provision is intended to prevent businesses from holding off on making investments while the tax reform process continues.
Real Property Recovery Periods	The recovery period for nonresidential real and residential rental property would be reduced to 25 years from 39 years and 27.5 years, respectively. The alternative depreciation system (ADS) recovery period for residential rental property would be reduced from 40 years to 30 years. The ADS recovery period for nonresidential real property would remain at 40 years. The recovery period for qualified improvement property (generally interior improvements to buildings that were previously placed in service) would be reduced to 10 years and the ADS recovery period would be 20 years. The special 15-year recovery period for qualified leasehold improvement property, retail and restaurant property would be repealed.	The ADS recovery periods for real property would be applicable for real property trades or businesses that elect out of the interest expense limitation. Qualified improvement property is the same definition that currently applies for 50% bonus depreciation. Thus, certain 15-year and 39-year property would have a 10-year recovery period.

[3] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

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SENATE TAX REFORM PROPOSAL – CORPORATE & BUSINESS

U.S. CORPORATE AND BUSINESS PROVISIONS[4]

Provision	Description of Proposed Change	Comments
Business Interest Expense Deduction Limitation	The deduction for net interest expense for most businesses would be limited to 30% of adjusted taxable income after 2017. The limitation would generally be applied at the taxpayer level except for partnerships, where it applies at the partnership level with special rules at the partner level to prevent double counting of income. S corporations are treated similarly to partnerships. Exceptions would be provided for small businesses and certain regulated public utilities. Farming businesses and real property trades or businesses would be able to elect not to apply the limitation but must then use ADS to depreciate property with a recovery period of 10 years or more (farming trade or business) or nonresidential real property, residential rental property, and qualified improvement property (real property trade or business) for depreciation. The provision includes an indefinite carry forward of disallowed amounts. The carryover attribute would belong to the business, but additional rules would permit a pass-through entity's unused limitation for the taxable year to be used by its owners. An additional limitation would apply to U.S. corporations that are part of an international financial reporting group.	Businesses with net interest expense should evaluate how changes to the capital structure would prevent permanent loss of interest deductions. A regime similar to Sec. 382 would prevent use of interest expense carryforwards following an ownership change. Businesses may need to record a valuation allowance for interest carryforwards. The definition of adjusted taxable income in the Senate bill does not add back depreciation or amortization, as the House bill does, thus would be a more restricting limitation. Real estate and farming businesses should evaluate whether to elect out of the net interest expense limitation, given the trade-off of longer recovery periods for certain property.
Net Operating Loss (NOL) Deduction	NOL carryovers would offset only 90% of a taxpayer's taxable income. For taxable years beginning after December 31, 2022, the limitation would be 80%. Generally, all carrybacks would be repealed (except for certain farming losses), and the provision would be effective for losses arising in tax years ending after December 31, 2017. NOLs arising in tax years beginning after December 31, 2017 can be carried forward indefinitely.	The provision essentially conforms the regular tax NOL utilization to the current AMT rule limited to only 90% of taxable income. Modifications to the Senate proposal further limit the utilization of NOLs to 80% of taxable income for tax years beginning after December 31, 2022. While the reduction of tax rates will negatively impact earnings of companies with net deferred tax assets, the indefinite carryover of post-2017 NOLs may benefit taxpayers that would otherwise have valuation allowances recorded against those federal NOL carryovers.

[4] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

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U.S. CORPORATE AND BUSINESS PROVISIONS[5]

Provision	Description of Proposed Change	Comments
Like-Kind Exchanges of Real Property	The like-kind exchange rules would be modified to allow for like-kind exchanges with respect to only real property for transfers after December 31, 2017. A transition rule would apply to certain like-kind exchanges of personal property not finalized on or before December 31, 2017.	Taxpayers that have deferred tax on the recognition of built-in gains in property will no longer be able to achieve this deferral on personal property.
Meals, Fringe Benefits and Entertainment Expenses	The provision disallows an employer's deduction for meals provided for the convenience of the employer on the employer's business premises or certain other employer-operated facilities effective after December 31, 2025. The provision disallows deductions for entertainment expenses and membership dues relating to such activities or other social purposes. In addition, no deduction would be allowed for transportation fringe benefits, benefits in the form of on-premises athletic facilities, or for certain amenities provided to an employee, except to the extent that such benefits are treated as taxable compensation to an employee (or includible in gross income of a recipient who is not an employee). A 50% limitation would continue to apply only to expenses for food or beverages and to qualifying business meals under the provision and the 50% limitation would be expanded to include expenses for food and beverages for employees that are a de minimis fringe benefit. Deductions for qualified transportation fringe benefits and commuting expense payments and reimbursements (other than for employee safety reasons) would be disallowed. The provision would generally be effective for amounts paid or incurred after December 31, 2017.	Businesses should consider how these changes would increase costs associated with employee perks and entertainment provided to employees and customers. Businesses should also consider how to track the value of amounts provided to employees and non-employees for purposes of reporting amounts to the recipients.

[5] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

U.S. CORPORATE AND BUSINESS PROVISIONS[6]		
Provision	**Description of Proposed Change**	**Comments**
Deduction for Executive Compensation	The rules governing the deductibility of compensation paid to covered employees of a publicly-held corporation would be modified as follows: 1) The performance-based exception would be eliminated, meaning that all compensation paid during the taxable year in excess of $1 million would not be deductible (with a transition rule for certain contracts that were in effect on November 2, 2017). 2) The definition of covered employee would include (i) the principal executive officer (PEO) and the principal financial officer (PFO) of the corporation at any time during the taxable year; (ii) the next three highest paid officers (other than the PEO or PFO); and (iii) any person who was a covered employee of the corporation for any taxable year beginning after December 31, 2016. 3) Finally, the definition of a publicly-held corporation would include all domestic publicly traded corporations and all foreign companies publicly traded through ADRs. The definition may also include certain additional corporations that are not publicly traded, such as large private C or S corporations that are required to file reports under the Securities Exchange Act of 1934. 4) Once an employee is treated as a covered employee, any further compensation paid to that person is treated as a payment to a covered employee. Remuneration paid to a covered employee would also include any amounts paid to a person other than the covered employee, including payment after the death of the covered employee.	These changes mean that the compensation deduction for all covered employees for any year in which they are a covered employee and any future year would be limited to $1 million. This would apply to any stock options exercised after December 31, 2017, the vesting of restricted stock or restricted stock units vesting after December 31, 2017, as well as the payment of any deferred compensation after December 31, 2017. If enacted, this provision would have a significant effect on the structure of CEO and top executive pay and may result in a significant tax increase for publicly traded companies with significant payments for CEO and top executive compensation.
Cost Basis of Securities Determined on FIFO Basis	The cost basis of any specified security sold, exchanged, or otherwise disposed of would be determined on a first-in, first-out (FIFO) basis. An exception is provided for mutual funds where an average cost basis is used.	
Limitation on Deduction for FDIC Premiums	No deduction would be allowed for Federal Deposit Insurance Corporation (FDIC) premiums paid by taxpayers with at least $50 billion of assets. A portion may be limited for taxpayers with at least $10 billion of assets.	
Repeal of Advance Refunding Bonds	The exclusion from gross income for interest on a bond issued to advance refund another bond.	

[6] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

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U.S. CORPORATE AND BUSINESS PROVISIONS[7]

Provision	Description of Proposed Change	Comments
Research or Experimental Expenditures and Software Development Costs	Certain research or experimental expenditures (R&E), including software development costs, would be required to be capitalized and amortized over a five-year period (15 years in the case of expenditures attributable to research conducted outside the United States). The provision would apply on a cutoff basis to R&E expenditures paid or incurred in taxable years beginning after December 31, 2025.	R&E costs and software development costs that are expensed for financial reporting purposes would be capitalized and amortized for tax purposes. This would be treated as a change in accounting method implemented on a cut-off basis and would generally result in an unfavorable book/tax difference.
Modification to Orphan Drug Credit	The credit rate would be reduced from 50% to 27.5% and a disclosure requirement would be included, effective for taxable years beginning after December 31, 2017. In addition, expenses related to use of a drug that was previously approved by the FDA for another purposes would generally not be eligible for the credit.	The Senate bill would trim back the orphan drug credit, while the House bill would eliminate the credit entirely.
Modification to Rehabilitation Credit	The 10% credit for pre-1936 buildings would be repealed. A 20% credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure.	
Expensing Costs of Replanting Citrus Plants	The modification to the Senate proposal allows a person other than the taxpayer to deduct replanting costs for citrus plants lost or damaged due to casualty if (1) the taxpayer has an equity interest of not less than 50% in the replanted plants and the other person has any remaining equity interest, or (2) the other person acquires all of the taxpayer's equity interest in the land. Effective for costs incurred after the date of enactment but not later than 10 years from the date of enactment.	
Craft Beverage Modernization	The modification to the Senate proposal provides that the aging periods of beer, wine, and distilled spirits would be excluded from calculation of the production period for purposes of the UNICAP interest capitalization rules. The exclusion would apply for interest costs paid or incurred after 2017 and expiring for tax years beginning after 2019.	

[7] Note that certain of the revenue raising provisions discussed below will be repealed for taxable years beginning after December 31, 2024, if cumulative aggregate on-budget federal revenue for the period beginning October 1, 2017, and ending September 30, 2026, exceeds a specified target. Affected provisions include, among others, the 80% limitation on net operating loss carryovers, the limitation on meals provided for the convenience of the employer and the 5-year capitalization requirement for research and experimentation expenses.

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U.S. CORPORATE AND BUSINESS PROVISIONS[8]		
Provision	**Description of Proposed Change**	**Comments**
Deductibility of Fines and Penalties and Sexual Harassment Costs for Federal Income Tax Purposes	The modification of the Senate proposal would deny a deduction for amounts paid in relation to the violation of a law or investigation into the potential violation of a law, if a government (or similar entity) is a complainant or investigator with respect to the violation or potential violation. An exception would apply to restitution (including remediation of property) identified in a court order or settlement agreement as restitution, remediation, or required to come into compliance with any law. Restitution for failure to pay tax, assessed under the Internal Revenue Code, would be deductible only to the extent it would have been allowable if it had been timely paid. An exception also would apply to any amount paid or incurred as taxes due. Effective for amounts paid or incurred after the date of enactment, except that it would not apply to amounts paid or incurred under any binding order or agreement entered into before such date unless such order or agreement required court approval and the approval was not obtained before such date. Effective after the date of enactment payments related to sexual harassment and sexual abuse, including settlements and related attorney's fees, are not deductible if subject to a nondisclosure agreement.	
Other Business Tax Base Broadeners	Attorneys working on a contingency fee basis can only deduct expenses once the contingency is resolved. Repeal the deduction for unused business credits. Additional changes are proposed to provisions related to life and property and casualty insurance companies, including the requirement to capitalize policy acquisition costs.	The last-in, first-out (LIFO) inventory method would not be repealed.

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