ANDERSEN TAX

TAX REFORM – CORPORATE & BUSINESS

The following chart sets forth some of the provisions affecting businesses in the Tax Reform Act of 2017 (the Act). This chart highlights only some of the key issues and is not intended to address all aspects of the legislation. If you have questions, please contact your Andersen Tax advisor.

U.S. CORPORATE AND BUSINESS PROVISIONS		
Provision	**Description of Change**	**Comments**
C Corporation Business Income Tax Rates	The regular corporate tax rate is lowered to a flat 21% rate (the special tax rate for personal services corporations is eliminated) effective for tax years beginning after December 31, 2017. 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 provision retains the effective date from the House bill, but the rate was increased to 21%. Corporate taxpayers should focus on accounting method changes to accelerate deductions and defer taxable income in advance of a rate reduction. Fiscal year corporations need to calculate a prorated tax liability.
Pass-Through Business Income Tax Rates	Individuals, trusts, and estates are allowed to deduct 20% 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 or income from a specified service trade or business or the trade or business of performing services as an employee. The amount of the deduction is generally limited to the greater of (i) 50% of the taxpayer's allocable share of W-2 wages or (ii) 25% of the taxpayer's allocable share of W-2 wages plus a capital element (the capital element is 2.5% of the original cost basis of depreciable tangible property used in the business in the current year and placed in service in the past 10 years (or at the end of the recovery period if the recovery period is longer than 10 years)). The W-2 wage limit does not apply to small taxpayers with taxable income not exceeding $315,000 for married filing jointly (MFJ) taxpayers or $157,500 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 20% deduction generally does not apply to specified service businesses, unless the taxpayer's taxable income is below the small taxpayer thresholds ($315,000/$157,500). 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. A specified service trade or business includes performance of services in the fields of health, law, accounting, actuarial sciences, performing arts, consulting, athletics, financial services, brokerage services, investing and investment management, trading or dealing in securities, partnership interest, 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 employees or owners. Engineering and architecture are not included in the definition of specified services. The deduction is taken into account in determining taxable income, instead of being an above-the-line deduction to compute adjusted gross income. The deduction is also allowed for alternative minimum tax (AMT) purposes. Qualified business income is reduced in the current year by qualified business losses in determining the amount of the deduction. If the net amount is a loss, the loss is carried forward and reduces qualified business income in the future for purposes of computing the deduction in a future year.	In lieu of a change in tax rates, a deduction is allowed for a portion of qualified business income from pass-through entities, similar to the prior law domestic production activities deduction under Sec. 199. With a top individual rate of 37%, this provision approximates a top rate of 29.6% for qualifying income. The limitation of the deduction to 50% of W-2 wages or 25% of W-2 plus capital element may be a significant limiter depending on the taxpayer's industry and structure. The addition of the capital element opens up the deduction to the real estate sector, which was largely excluded under the original Senate bill. Specified service businesses generally do not receive any deduction once the $415,000 (MFJ) and $207,500 thresholds are surpassed and the deduction is phased out. Further, only amounts in excess of reasonable compensation will qualify. Unlike the Senate bill, the deduction applies to trusts and estates. Dividends from a REIT and qualified publicly traded partnership income are also qualified income, and are not subject to the wage/capital element limitation.

U.S. CORPORATE AND BUSINESS PROVISIONS

Provision	Description of Change	Comments
Pass-Through Business Income Tax Rates (Cont.)	The deduction is effective for taxable years beginning after December 31, 2017. The deduction expires after 2025.	
Domestic Production Activities Deduction (DPAD)	The Sec. 199 deduction for income attributable to domestic production activities is repealed for taxable years beginning after December 31, 2017.	Fiscal year taxpayers are entitled to the Sec. 199 deduction for taxable years that begin before January 1, 2018.
Alternative Minimum Tax	The corporate alternative minimum tax (AMT) is repealed. AMT credits can be offset against regular tax, and an amount equal to 50% of the excess of the AMT credit over the amount that offset regular tax is refundable in 2018, 2019, and 2020. In 2021, any remaining AMT credit becomes refundable.	
Revenue Recognition	Accrual method taxpayers are 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 is codified. The longer deferral rule for advance payments under Reg. 1.451-5 is intended to be repealed. Revenue recognition rules under Sec. 451 are applied before rules applicable to OID, market discount on bonds, and stripped bonds and stripped coupons other than mortgage servicing rights. These changes are effective for taxable years beginning after December 31, 2018 and are treated as a change in method of accounting. A six-year spread period is provided for a positive adjustment related to the OID change.	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 A $25 million average gross receipts threshold applies 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 is indexed for inflation. The provision repeals the requirement that such businesses satisfy the requirement for all prior years. UNICAP and inventory exemption Taxpayers meeting the $25 million average gross receipts test are exempt from UNICAP for real and personal property acquired or manufactured. Taxpayers meeting this threshold are also exempt from the requirement to keep inventories under Sec. 471, but rather may use a method of accounting that treats inventory as non-incidental material and supplies, or conforms to the taxpayers' financial statements or books and records. These provisions apply for taxable years beginning after December 31, 2017. Long-term Contracts A $25 million average gross receipts threshold applies 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 taxable years beginning after December 31, 2017.	These provisions may help smaller taxpayers reduce the overall costs and administrative burdens related to tax compliance. The $25 million gross receipts threshold is based on a prior three-year average. An aggregation rule is provided for related parties for purposes of computing the $25 million threshold. The cash method provision does 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 pre-existing law are not restricted under the Act).

U.S. CORPORATE AND BUSINESS PROVISIONS		
Provision	**Description of Change**	**Comments**
Accounting Methods for Small Businesses (Cont.)	<u>Expensing</u> The limitation for small business expensing of depreciable assets under Sec. 179 is increased to $1 million and the phase-out amount is increased to $2.5 million effective for tax years beginning after December 31, 2017. Eligible property is expanded somewhat.	
Cost Recovery / Increased Expensing	Expensing of 100% of the cost of new investments in qualified depreciable property acquired and placed in service after September 27, 2017 and before January 1, 2023. The expensing phases out between 2023 and 2026 with 80% in 2023, 60% in 2024, 40% in 2025 and 20% in 2026. An additional year is available for certain qualified property with a longer production period. The requirement that the original use of qualified property must commence with the taxpayer has been removed (i.e., the scope of the additional first-year depreciation deduction is expanded to include used property). The Act contains any property used by a regulated public utility company or for property used in a trade or business that had excluded floor plan financing interest from the interest limitation under Sec. 163(j). Qualified property is expanded to include qualified films, television and live theatrical productions (property covered under pre-existing law Sec. 181) placed in service after September 27, 2017 and before January 1, 2027. The pre-existing law phase-down of bonus depreciation is maintained for property acquired before September 28, 2017 and placed in service after September 27, 2017. A transition rule allows taxpayers to elect to apply pre-existing law 50% bonus depreciation for the first taxable year ending after September 27, 2017. The election to use AMT credits in lieu of accelerated depreciation is repealed. The repeal of the election is effective for tax years beginning after December 31, 2017. As under prior law, an election out of bonus depreciation is available for any class of property.	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. The Act does not include the provision in the House bill that would have prevented additional bonus depreciation from September 27, 2017 to December 31, 2017 from generating additional loss for an NOL carryback claim. There is an interrelationship between the exceptions to accelerated expensing and the Sec. 163(j) interest expense deduction limitation. Real estate and farming businesses should evaluate whether the tax benefit of MACRS and bonus depreciation for certain property where ADS is required for an electing business outweighs the effect of the net interest expense deduction limitation.
Property Recovery Periods	The recovery period for nonresidential real and residential rental property remains at pre-existing law levels of 39 years and 27.5 years, respectively. The Senate bill proposed shortening these recovery periods, but those provisions were not retained. The alternative depreciation system (ADS) recovery period for residential rental property is reduced from 40 years to 30 years. The ADS recovery period for nonresidential real property remains at 40 years. Separate definitions for qualified leasehold improvement, qualified restaurant, and qualified retail improvement property are eliminated for property placed in service after December 31, 2017. A general 15-year MACRS recovery period is used for qualified improvement property; the ADS recovery period for such property is 20 years for property placed in service after December 31, 2017. The recovery period for machinery or equipment used in a farming business, the original use of which commences with the taxpayer, is shortened to 5 years (from 7 years). The requirement to use 150% declining balance is repealed. The provision applies to property placed in service after December 31, 2017.	The ADS recovery periods for real property are applicable for real property trades or businesses that elect out of the interest expense limitation. Qualified improvement property is the same definition that applied for 50% bonus depreciation under pre-existing law. Thus, certain 39-year property may now have a 15-year recovery period. There is a technical issue related to the legislative language providing the 15-year recovery period, and it appears, absent further guidance or a technical correct, that a 39-year life applies and the property is not bonus eligible.

U.S. CORPORATE AND BUSINESS PROVISIONS		
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Business Interest Expense Deduction Limitation	The deduction for net interest expense for most businesses is limited to 30% of adjusted taxable income after 2017. The limitation is generally 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 are provided for small businesses and certain regulated public utilities. Farming businesses and real property trades or businesses are 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. In addition, no limit applies with respect to floor plan financing interest, but such businesses cannot take bonus depreciation. For taxable years beginning after December 31, 2017 and before January 1, 2022, the definition of adjusted taxable income (ATI) in the Act is computed without regard to deductions allowable for depreciation, amortization, or depletion. After January 1, 2022, ATI will follow what was provided in the Senate bill (i.e., no add back for depreciation or amortization). Thus, the limitation will be more restrictive in future years. The Act exempts from the limitation taxpayers with average annual gross receipts for the three-taxable year period ending with the prior taxable year that do not exceed $25 million. The provision includes an indefinite carry forward of disallowed amounts. Sec. 382 limitations apply to the carryforward of disallowed business interest in a corporate acquisition. Special rules apply in the case of partnerships. The excess business interest flows to the partner as a separately stated item and reduces basis. Future excess taxable income from the partnership interest can be used to absorb excess business interest from prior years. Upon disposal of a partnership interest where there is an excess interest carryforward, the partner's basis is increased by the amount of the carryforward.	Businesses with net interest expense should evaluate how changes to the capital structure will prevent permanent loss of interest deductions. A regime similar to Sec. 382 will prevent use of interest expense carryforwards following an ownership change. Businesses may need to record a valuation allowance for interest carryforwards. 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. Partnerships with leverage in their structures will need to carefully model the impact of the provision and may need to make revisions to the debt structure.
Net Operating Loss (NOL) Deduction	NOL carryovers offset only 80% of a taxpayer's taxable income for losses arising in taxable years beginning after December 31, 2017. Generally, all carrybacks are repealed (except for certain farming losses), and the provision is effective for losses arising in tax years ending after December 31, 2017. Special rules are provided for insurance companies. NOLs arising in tax years beginning after December 31, 2017 can be carried forward indefinitely (rather than 20 years under prior law).	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. The proposal in the House bill to adjust NOLs for inflation was not included in the Act.
Like-Kind Exchanges of Real Property	The like-kind exchange rules are modified to allow for like-kind exchanges with respect to only real property for transfers after December 31, 2017. A transition rule applies to certain like-kind exchanges of personal property where the property disposed of by the taxpayer is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received by 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.

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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 is 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 continues to apply only to expenses for food or beverages and to qualifying business meals under the provision and the 50% limitation is 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) are disallowed. The provision is generally effective for amounts paid or incurred after December 31, 2017.	Businesses should consider how these changes will 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.
Modify Treatment of S Corporation Conversions into C Corporations	If a corporation was an S corporation on the day before the law was enacted and converts to a C corporation by revocation during the following two years and has the same owners (and in identical proportions) on the date of enactment date and the date the S Corp election is revoked, then (1) the adjustment due to a change in accounting methods attributable to the revocation is taken into account ratably over six years, and (2) cash distributions after the post-termination transition period are treated as coming proportionately from the accumulated adjustments account and from C corporation earnings and profits rather than first coming from the accumulated adjustment account and then earnings and profits.	
Contributions to Capital Included in Gross Income	The Act does not repeal Sec. 118, but rather it provides that the term "contributions to capital" does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such). The Act intends that Sec. 118, as modified, continues to apply only to corporations. The provision applies to contributions made after the date of enactment.	The bill passed by the House would have repealed Sec. 118 and provided that gross income of a corporation would include contributions to its capital to the extent the amount of money and the fair market value (FMV) of property contributed to the corporation exceeds the FMV of any stock that is issued in exchange for the contribution. Similar rules would have applied to non-corporate entities. This should not generally impact Sec. 351 or Sec. 721 contributions.

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Deduction for Executive Compensation	The rules governing the deductibility of compensation paid to covered employees of a publicly-held corporation are modified as follows: 1) The performance-based exception is eliminated, meaning that all compensation paid during the taxable year in excess of $1 million is not deductible. 2) The definition of covered employee includes (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 includes all domestic publicly traded corporations and all foreign companies publicly traded through American Depository Receipts (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 future compensation paid to that person is treated as a payment to a covered employee. 5) Remuneration paid to a covered employee also includes any amounts paid to a person other than the covered employee, including payment after the death of the covered employee. 6) The Act provides a transitional rule such that remuneration under a binding written contract in effect as of November 2, 2017, which is not significantly modified after that date is not subject to the new limitations.	These rules apply for taxable years beginning after December 31, 2017. However, these rules do not apply to written binding contracts in existence on November 2, 2017. Compensation paid pursuant to a plan qualifies for the exception provided that the right to participate in the plan is part of a written binding contract with the covered employee in effect on November 2, 2017. The fact that the plan was in existence on November 2, 2017 is not itself sufficient to qualify for the exception. 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 is limited to $1 million. This provision could 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.
Cost Basis of Securities	The Act does not change current law.	The Senate bill would have required taxpayers to calculate cost basis in securities under a first-in first-out (FIFO) method. This would have eliminated a taxpayer’s ability to specifically identify shares sold. The Act does not include this provision.
Limitation on Deduction for FDIC Premiums	No deduction is 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	Repeals the exclusion from gross income for interest on a bond issued to advance refund another bond.	

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Research or Experimental Expenditures and Software Development Costs	Certain research or experimental expenditures (R&E), including software development costs, are 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 applies on a cutoff basis to R&E expenditures paid or incurred in taxable years beginning after December 31, 2021.	R&E costs and software development costs that are expensed for financial reporting purposes are capitalized and amortized for tax purposes. This is treated as a change in accounting method implemented on a cut-off basis and generally will result in an unfavorable book/tax difference.
Modification to Orphan Drug Credit	The credit rate is reduced from 50% to 25% and a disclosure requirement is 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 are generally not eligible for the credit.	
Modification to Rehabilitation Credit	The 10% credit for pre-1936 buildings is repealed. A 20% credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure, with modifications. The provision applies to amounts paid or incurred after December 31, 2017 and a special transition rule is also included.	
Expensing Costs of Replanting Citrus Plants	The Act maintains the Senate proposal to allow 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 Act provides that the aging periods of beer, wine, and distilled spirits are excluded from calculation of the production period for purposes of the UNICAP interest capitalization rules. The exclusion applies for interest costs paid or incurred after 2017 and expiring for tax years beginning after 2019.	
Repeal of Rollover of Publicly-Traded Securities Gain into Specialized Small Business Investment Companies (SSBIC)	The special rule permitting gains on publicly traded securities to be rolled over to an SSBIC is repealed. The provision is effective for sales after 2017.	
Self-Created Property Not Treated as a Capital Asset	A self-created patent, invention, model or design, or secret formula or process no longer qualifies as a capital asset under Sec. 1221 and any gain or loss from a disposition is ordinary in character. The election to treat musical composition and copyright in musical works as a capital asset is preserved. Effective for disposition of such property after 2017. The special rule under Sec. 1235 treating certain transfers of a patent before its commercial exploitation as long-term capital gain is retained.	Taxpayers contemplating a future disposition of the specified intangibles should consider whether the disposition can be accelerated into 2017 if a built-in gain exists.

U.S. CORPORATE AND BUSINESS PROVISIONS		
Provision	**Description of Change**	**Comments**
Deductibility of Fines and Penalties and Sexual Harassment Costs for Federal Income Tax Purposes	A deduction is denied 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 applies 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, is deductible only to the extent it would have been allowable if it had been timely paid. An exception also applies to any amount paid or incurred as taxes due. Effective for amounts paid or incurred after the date of enactment, except that it does 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. The deduction for lobbying expenses with respect to legislation before local governmental bodies is disallowed for amounts paid or incurred after enactment. Additional changes are included in provisions related to life and property and casualty insurance companies, including the requirement to capitalize policy acquisition costs. The Research Credit, Work Opportunity Tax Credit, New Markets Tax Credit and deduction for unused business credits are retained.	The last-in, first-out (LIFO) inventory method is not repealed.