

## Key Corporate & Business Tax Provisions

On December 20, 2017, Congress passed a statute originally named the Tax Cuts and Jobs Act (the “Act”), which enacts a broad range of tax changes. The Act was signed by the President on December 22. This alert briefly summarizes some of the key federal income tax provisions of the Act affecting corporations.

### Corporate Tax Rate Cut

For tax years beginning after December 31, 2017, corporate income will be taxed at a flat 21% rate. A blended statutory rate based on a weighted average of the rates in place before and after the effective date will apply to fiscal year taxpayers.

Deductions for dividends received from less than wholly owned domestic corporations are reduced to 65% (for dividends paid from a 20% or greater subsidiary) or 50% (for dividends paid from any other non-consolidated corporation). Consequently, such dividends will be subject to roughly the same effective tax rates as the maximum rates imposed under present law (i.e., 7% and 10%, respectively).

### General Business Interest Expense Deduction Limitation

The Act significantly restricts the deductibility of interest paid or accrued by certain businesses (“**business interest**”) for tax years beginning after December 31, 2017 (i.e., including interest paid on existing indebtedness), regardless of the form of the business. The deduction for business interest is generally limited to the sum of business interest income and 30% of adjusted taxable income. For this purpose, adjusted taxable income generally is earnings before interest, taxes, depreciation, and amortization (“**EBITDA**”) for tax years beginning before 2022 and earnings before interest and taxes (“**EBIT**”) for tax years thereafter.

Disallowed business interest expense may be carried forward indefinitely, but such carryforwards are subject to limitation following certain subsequent ownership changes in the business.

The limitation does not apply to most small businesses (other than tax shelters) or certain regulated public utilities. Additionally, some taxpayers (including certain real estate and farming businesses) may elect not to be subject to this limitation.

Corporate partners of partnerships should be aware that (i) the limitation applies at the entity level for partnerships, (ii) the carryforward for disallowed business interest of a partnership will be allocated to its partners, and (iii) a partner’s adjusted taxable income for purposes of its own limitation calculation will not include its distributive share of partnership income or loss.

### Elimination of Corporate Alternative Minimum Tax (“AMT”)

The corporate AMT is repealed for tax years beginning after December 31, 2017. AMT credit carryforwards continue to be permitted to offset regular tax liability. From 2018 to 2020, up to 50% of any excess of the credit remaining after such offset will be refundable; any balance remaining in 2021 will be fully refundable.

### Net Operating Loss Deduction Limitation

For tax years beginning after December 31, 2017, the net operating loss (“**NOL**”) deduction is limited to 80% of taxable income (computed without regard to the NOL deduction).

Effective for losses arising in tax years beginning after December 31, 2017, the Act generally repeals the two-year carryback provision (except with respect to certain farming and insurance company losses), but extends the carryforward period from 20 years to allow for the indefinite carryforward of NOLs.

### Extension and Modification of Bonus Depreciation

The phase-down of the additional 50% first-year depreciation deduction continues to apply to qualified property acquired before September 28, 2017 and placed in service after September 27, 2017. However, the Act delays the phase-down and increases the bonus depreciation percentage to 100% for qualified property acquired and placed in service on or after September 28, 2017 through December 31, 2022 (or December 31, 2023 for longer production property and certain aircraft), allowing businesses to immediately deduct the full cost of such property. The bonus depreciation percentage will gradually be reduced for property placed in service thereafter, and the deduction will phase out entirely by December 31, 2026 (or December 31, 2027 for longer production property and certain aircraft).

For this purpose, qualified property may be purchased new or used. Film, television and qualified live theatrical productions are permitted to expense costs in the year of a production's release, effectively reviving similar provisions that had expired at the end of 2016.

A transition rule provides that, for a taxpayer's first tax year ending after September 27, 2017, the taxpayer may elect to apply a 50% allowance (the previously applicable rate) in lieu of 100%.

*Note that the Act also modifies the rules regarding the depreciation of luxury automobiles, personal use property, nonresidential real property, residential rental property, and farming property.*

### **Expansion of Deduction for Property Acquisitions**

For tax years beginning after December 31, 2017, the Act doubles (to \$1 million) the amount a taxpayer may deduct for the cost of property purchased for use in the active conduct of a trade or business (including certain real property and improvements) and placed in service for the tax year. The phase-out threshold amount is also increased, to \$2.5 million. These amounts are indexed for inflation for tax years beginning after 2018.

### **Modification of Treatment of Certain Contributions**

Under the Act, a corporation must include in gross income certain contributions made by persons who are not shareholders, including, generally, contributions made after the date of enactment of the Act that are made in aid of construction by a customer or potential customer or are made by governmental entities or civic groups that are not shareholders.

### **Accounting Method Changes for Small Businesses**

The Act includes several provisions modifying accounting methods for businesses with average annual gross receipts of \$25 million or less for tax years beginning in 2018:

- *Cash method of accounting.* Corporations and partnerships with a corporate partner (including farming corporations and partnerships) with gross receipts not exceeding \$25 million for the three prior tax years (the "**\$25 million gross receipts test**") may use the cash method of accounting (the maximum threshold under current law is \$5 million). Current exemptions from the required use of accrual accounting for personal service corporations, partnerships without corporate partners, and other pass-through entities remain unchanged.
- *Accounting for inventories.* Businesses that meet the \$25 million gross receipts test are permitted to use the cash method of accounting even if they have inventories, and may treat inventory items as non-incident materials and supplies or conform to their book treatment of such items. In addition, such businesses are fully exempt from the uniform capitalization ("**UNICAP**") rules, which generally

require manufacturers and certain retailers and wholesalers to capitalize direct and indirect costs associated with property produced and purchased for resale.

- *Accounting for long-term contracts.* Businesses qualify for the exception from the requirement to use the percentage-of-completion method for construction, installation, and manufacturing contracts entered into after December 31, 2017 if (i) the contract is expected (at the time entered into) to be completed within two years of commencement, and (ii) the business performing under the contract meets the \$25 million gross receipts test for the year in which the contract was initiated.

### **Other Accounting Method Changes**

Starting in 2018, the Act requires accrual method taxpayers to recognize gross income for tax purposes no later than the tax year in which such income is taken into account as income on an "applicable financial statement," but provides exceptions for any item of income (i) for which a special method of accounting is used (other than the special methods of accounting applicable to bonds and other debt instruments, including the original issue discount rules) or (ii) which is connected with a mortgage servicing contract. For this purpose, an applicable financial statement includes a financial statement prepared using generally accepted accounting principles ("**GAAP**") and prepared for nontax reasons such as a Form 10-K or governmental filing, for credit purposes, or for reporting to owners. This provision should be considered in conjunction with ASC 606, Revenue from Contracts with Customers, which may in some cases accelerate recognition of revenue for financial statement purposes and will be effective for annual reporting periods of public companies (including interim reporting periods within those periods) beginning after December 15, 2017 and for annual reporting periods of private companies beginning after December 15, 2018.

The Act codifies the current deferral method of accounting for advance payment for goods and services provided by the Internal Revenue Service ("**IRS**") under Revenue Procedure 2004-34, which allows accrual method taxpayers to elect to defer income from certain advance payments to the tax year following the year of receipt, to the extent deferred for financial statement purposes.

*A business adapting its accounting methods due to any of the newly applicable rules discussed above may be required to report such changes in accounting method to the IRS, and such changes may also result in increases or decreases to taxable income in the tax year of the change and, in certain cases, multiple subsequent tax years.*

This Alert provides only a simple overview of complex and nuanced tax provisions. Given the fluid fiscal and legislative environment, there may be additional changes coming. To learn more about the Act and its implications for you or your business, please contact one of the Lowenstein Sandler attorneys listed.

For more information about other provisions of the Act, please see the links below:

[KEY PARTNERSHIP TAX PROVISIONS](#)

[KEY INDIVIDUAL TAX PROVISIONS](#)

[KEY FOREIGN TAX PROVISIONS](#)

[KEY TAX-EXEMPT ORGANIZATION TAX PROVISIONS](#)

[KEY TRUST & ESTATE TAX PROVISIONS](#)

[KEY TAX PROVISIONS AFFECTING HEDGE FUNDS, PRIVATE EQUITY FUNDS AND OTHER INVESTMENT VEHICLES](#)

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