# PIECES OF THE PUZZLE

## December 2017

# The Tax Cuts and Jobs Act Summary of Business Tax Changes

The following is a summary of the business tax changes in the "Tax Cuts and Jobs Act" signed by President Trump. Please note that most of these are for tax paying regular or "C" corporations and a summary of S corporation/Partnership changes will be issued separately.

**Corporate Tax Rates Reduced**

Under pre-Act law, corporations are subject to graduated tax rates of 15%, 25%, 34%, and 35%. For tax years beginning after December 31, 2017, the corporate tax rate is a flat 21% rate.

**Alternative Minimum Tax Repealed**

Under pre-Act law, the corporate alternative minimum tax (AMT) is 20%, with an exemption amount of up to $40,000. For tax years beginning after December 31, 2017, the corporate AMT is repealed.

**Increased Code 179 Expensing**

For property placed in service in tax years beginning after December 31, 2017, the maximum amount a taxpayer may expense under code section 179 is increased to $1 million, and the phase out threshold amount is increased to $2.5 million. Further, the definition of qualified real property eligible for code section 179 expensing 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.

**Temporary 100% Cost Recovery of Qualifying Business Assets**

Under pre-Act law, an additional first year bonus depreciation deduction was allowed equal to 50% of the adjusted basis of qualified property, the original use of which began with the taxpayer, placed in service before January 1, 2020. Under the law, a 100% first year deduction for the adjusted basis is allowed for a qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. The additional first year depreciation deduction is allowed for new and used property.

**Luxury Automobile Depreciation Limits Increased**

For passenger automobiles placed in service after December 31, 2017, and tax years ending after that date, for which the bonus depreciation deduction is not claimed, the maximum amount of allowable depreciation is increased to: $10,000 for the year which the vehicle is placed into service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period.

**New Farming Equipment and Machinery is Five Year**

For property placed in service after December 31, 2017, and tax years ending after that date, the cost recovery period is shortened from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original of which begins with the taxpayer.

**Recovery Period for Real Property Shortened**

The cost recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. Under pre-Act law, qualified leasehold improvement property was an interior building improvement to nonresidential real property, by a landlord, tenant, or subtenant, that was placed in service more than three years after the building is in service and that meets other requirements. Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was placed in service. Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

For property place in service after December 31, 2017, the separate definitions of leasehold improvement, qualified restaurant, and qualified retail improvement property are eliminated; a general 15 year recovery period and straight line depreciation are provided for qualified improvement property. Thus, qualified improvement property placed in service after December 31, 2017, is generally depreciable over 15 years using the straight line method and half year convention.

**Limits on Deduction of Business Interest**

Under pre-Act law, interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations. For tax years beginning after December 31, 2017, every business regardless of its form, is generally subjected 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, which requires the determination to be made at the entity level, for example, at the partnership level instead of the partner level.

For tax years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income is computed without regard to deductions for depreciation, amortization, or depletion and without the former code section 199 deduction. 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. However, there is an exemption from these rules for taxpayers with average annual gross receipts for the three-tax year period ending with the prior tax year that did not exceed $25 million.

In the case of a partnership, any business interest that is not allowed as a deduction to the partnership for the tax year is allocated to each partner in the same manner as non-separately stated taxable income or loss of the partnership. The partner may deduct its share of the partnership's excess business interest in any future year, but only against excess taxable income attributed to the partner by the partnership the activity of which gave rise to the excess business interest carry forward.

**Modification of Net Operating Loss Deduction**

Under pre-Act law, a Net Operating Loss (NOL) may generally be carried back two years and carried over 20 years to offset taxable income in such years. For NOLs arising in tax years after December 31, 2017, the two year carry back and special carry back previsions are repealed. For losses arising in tax years beginning after December 31, 2017, the NOL deduction is limited to 80% of taxable income and the NOLs can be carried forward indefinitely.

**Domestic Production Activities Deduction Repealed**

Under pre-Act law, taxpayers could claim a Domestic Production Activities Deduction (DPAD) for certain activities that were deemed to be qualified production activities within the United States. For tax years beginning after December 31, 2017, the DPAD is repealed.

**Like-Kind Exchange Treatment Limited**

Under pre-Act law, the Like-kind Exchange rule provided that no gain or loss was recognized to the extent that property held for the productive use of the taxpayer's trade or business or investment is exchanged for property of a like-kind that is also held for productive use in a trade or business or for investment.

Generally effective for transfers after December 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.

**Five-Year Write Off of Specified R&E Expenses**

Under pre-Act law, taxpayers may elect to deduct currently the amount of certain reasonable research or experimentation (R&E) expenses paid or incurred in connection with a trade or business. For amounts paid or incurred in tax years beginning after December 31, 2021, "specified R&E expenses" must be capitalized and amortized ratably over a five year period.

**Employer's Deduction for Fringe Benefit Expenses Limited**

Under current law, a taxpayer may deduct up to 50% of expenses relating to meals and entertainment. For amounts incurred or paid after December 31, 2017, deductions for entertainment expenses are disallowed, eliminating the subjective determination of whether such expenses are sufficiently business related; the current 50% limit on the deductibility of business meals is expanded to meals provided through an in house cafeteria or otherwise on the premises of the employer; and the deductions for employee transportation fringe benefits (e.g., parking and mass transit) are denied.

For tax years beginning after December 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 premise.

**Nondeductible Penalties and Fines**

For amounts generally paid or incurred on or after the date of enactment, no deduction is allowed for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or a specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

**Taxable Year of Inclusion**

Generally for tax years beginning after December 31, 2017, a taxpayer is required to recognize income no later than the tax year in which such income is taken into account as income on the applicable financial statement (AFS) or other financial statement under rules specified by the IRS.

The Act also codifies the current deferral method of accounting for advanced payments for goods and services to allow taxpayers to defer the inclusion of income associated with certain advanced payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.

**Cash Method of Accounting**

For tax years beginning after December 31, 2017, the cash method may be used by taxpayers that satisfy a $25 million gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income producing factor. Under the gross receipts test, taxpayers with annual average gross receipt that do not exceed $25 million for the prior three tax years are allowed to use the cash method. The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C-corporations are retained.

**Accounting for Inventories**

Under pre-Act law, businesses required to use an inventory method must generally use the accrual accounting method. For tax years beginning after December 31, 2017, the taxpayers that meet the $25 million gross receipts test are not required to account for inventories under the accrual accounting method, but rather may use an accounting method for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

**Capitalization and Inclusion of Certain Expenses in Inventory Costs**

The Uniform Capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included either in inventory or capitalized in the basis of such property. For tax year beginning after December 31, 2017, any producer or reseller of real or tangible personal property that meets the $25 million gross receipts test is exempted from the application of the UNICAP rules. The previous exemptions from the UNICAP rules that are not based on a taxpayer's gross receipts are retained.

**Accounting for Long Term Contracts**

Under pre-Act law, an exception from the requirement to use the Percentage of Completion Method (PCM) for long term contracts was provided for construction companies with average annual gross receipts of $10 million or less in the preceding three years. For contracts entered into after December 31, 2017, and tax years ending after that date, the exception for small construction contracts from the requirement to use the PCM is expanded to apply to contracts for the construction or improvement of real property if the contract: (1) is expected at the time that such contract is entered into to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that meets the $25 million gross receipts test.

This has been a summary of business tax changes from the Tax Cuts and Jobs Act. If you have any questions, please feel free to contact us.

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