Final tax bill to make major changes for domestic businesses

Conference agreement includes provision from both bills

Tax Alert | December 18, 2017

On Dec. 15, the House and Senate conferees agreed to the final provisions of the Tax Cuts and Jobs Act (TCJA) and released their conference committee report.

The agreement includes several important tax changes that will directly impact domestic businesses. The main provisions agreed to include the following:

- **Corporate tax rate** – Rates would fall from a top rate of 35 percent to 21 percent for tax years beginning after Dec. 31, 2017
- **Corporate Alternative Minimum Tax** – The corporate AMT would be repealed for tax years beginning after Dec. 31, 2017
- **Pass-through businesses** – Allows a deduction that is tantamount to excluding 20 percent of the business income of many pass-through entities and sole proprietors for taxable years of the owner beginning after Dec. 31, 2017. For owners otherwise subject to the top 37 percent individual tax rate, their effective tax rate on qualified income would be reduced to 29.6 percent
    - Pass-through owners whose taxable income exceeds $315,000 for a joint return (or lower amounts for single filers) would be subject to restrictions on the deduction in situations where the business did not have a specified level of wage payments or a specified amount of tangible, depreciable assets used in the business. In addition, restrictions on the deduction would apply to certain service businesses and other business described in the new law
    - Trusts and estates would be eligible for the 20 percent deduction
    - A new restriction would limit an owner's ability to deduct active business losses against nonbusiness income
- **Carried interests** – The agreement creates a new 3-year holding period that must be satisfied to enjoy long-term capital gains rates with respect to certain carried interests in certain investment or real estate funds
- **Capital expensing** – The legislation would provide for immediate expensing (i.e., 100 percent bonus depreciation) for certain qualified assets acquired and placed in service after Sept 27, 2017. The 100 percent bonus depreciation benefit would begin to phase out in 2023. The final bill would also increase the expensing allowance under Section 179 to $1 million, also subject to a phase-out
- **Business interest** – The deduction for net business interest of corporations and many passthrough businesses would be limited under a formula. Generally speaking, deductions could not exceed 30 percent of EBITDA (earnings before interest, taxes, depreciation, and amortization – following the House approach) for the next four years. After that period, interest deductions could not exceed 30 percent of EBIT (earnings before interest and taxes – following the Senate approach). Disallowed interest deductions could be carried forward. Certain taxpayers would be exempted from these rules, including taxpayers with average gross receipts of $25 million or less for the three years immediately preceding the effective date of this provision, as well as taxpayers involved in certain real estate activities
- **Net operating losses (NOLs)** – The agreement would limit the NOL deduction to 80 percent of taxable income for losses arising in tax years beginning after Dec. 31, 2017. Carrybacks would generally be eliminated, but unused losses could be carried forward indefinitely

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- **Domestic manufacturing deduction** – The Section 199 domestic production deduction would be repealed for tax years beginning after Dec. 31, 2017
- **Research credit and expenses** – The legislation retains the research and development credit and requires capitalization and amortization of research and experimental expenses over a 5-year period. The capitalization provisions would apply to amounts paid or incurred in tax years beginning after Dec. 31, 2021
- **Overall methods of accounting** – The agreement increases the gross receipts threshold above which C-corporations and partnerships with C-corporation partners must generally use the accrual method of accounting. The conference agreement increases the threshold from $5 million to $25 million
- **Like-kind exchanges** – Like-kind exchanges under Section 1031 would be limited to real property that is not held primarily for sale. Personal property would no longer qualify for taxdeferred treatment

It is expected that both the House and Senate will vote on the legislation this week. As we continue to review the final legislation, we will provide more in-depth coverage of these and many other provisions.

Read the conference committee report (legislative text and Joint Committee on Taxation estimate).

Read the conference committee's Joint Explanatory Statement that explains the bill.

Please see our additional tax alerts for details regarding the individual, pass-through, and international aspects of the conference agreement on the final proposed legislation.

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