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Tax Cuts and Jobs Act – Significant Changes Affecting Corporations and Businesses

The Tax Cuts and Jobs Act includes a number of provisions affecting the taxation of C corporations, as well as other taxpayers engaged in business activities, and is generally effective for tax years beginning after Dec. 31, 2017. It creates new issues and opportunities to consider for structuring business operations in the most optimal manner from an income tax perspective.

Some of the more significant changes affecting corporations (references to corporations are intended to be references to C corporations) and other taxpayers engaged in business activities include the following:

- **Corporate Tax Rate**. Corporations are subject to a flat 21% tax rate on income (rather than graduated rate with a maximum rate of 35%). The corporate AMT is repealed, as well as the special tax rate for personal service corporations.
- **Dividends Received Deduction**. The dividends received deductions applicable to corporations for dividends from 20% owned and less than 20% owned corporations are decreased to 65% and 50%, respectively (rather than 80% and 70%, respectively).
- **Net Operating Loss Deduction**. The deduction for net operating losses ("NOLs") is limited to 80% of a taxpayer's taxable income. In general, the two-year carryback of NOLs is repealed, but NOLs carryover indefinitely if not used (rather than expiring after 20 years). NOLs arising in tax years prior to 2018 are not affected by these changes.
- **Domestic Production Activities Deduction**. The "manufacturing" deduction for income attributable to domestic production activity is repealed.
- **Accounting Methods**. In general, accrual method taxpayers are required to recognize income in the taxable year in which the income is recognized for book purposes. Businesses with average gross receipts of less than $25 million will be permitted to use the cash method of accounting (a significant increase from the previous $5 million threshold).
- **Bonus Depreciation**. Corporations and other taxpayers engaged in business activities are permitted to expense 100% of the cost of new and used qualified depreciable property placed in service after Sept. 27, 2017, and before Jan. 1, 2023. The expensing percentage will be phased out over time with 80% in 2023, 60% in 2024, 40% in 2025 and 20% in 2026. Longer production period property and certain aircraft property will have an additional year to be placed in service at each rate.
- **Expensing**. The maximum amount permitted to be deducted for the cost of any "section 179 property" is increased to $1 million (from the prior limit of $500,000), reduced dollar-for-dollar to the extent the total cost of section 179 property placed in service in a taxable year exceeds $2.5 million (rather than $2 million).

- **Capitalized Research and Experimental Expenses**. Certain research or experimental ("R&E") costs that are paid or incurred in taxable years beginning after Dec. 31, 2021, including software development costs, must be capitalized and amortized generally over a five-year period (rather than allowed to elect either to expense currently or amortize over five years).
- **Property Recovery Periods**. For property placed in service beginning in 2018, the recovery period for residential real property under the alternative depreciation system ("ADS") is reduced from 40 years to 30 years. The special definitions for qualified leasehold improvement property, qualified restaurant property and qualified retail improvement property are eliminated, and instead, any qualified improvement property (generally any improvement to non-residential real property) is subject to a single 15-year recovery period (20 years for ADS).
- **Limitations on the Business Interest Expense Deduction**. The deduction for net business interest expense is limited to 30% of the adjusted taxable income of a corporation or other taxpayer engaged in business activities, plus "floor plan" financing interest (indebtedness used to finance the acquisition of motor vehicles held for sale or lease and secured by the inventory so acquired). Adjusted taxable income generally is a taxpayer's taxable income without taking into account any non-business tax items, business interest expense or income or net operating loss deductions. For tax years 2018-2021, adjusted taxable income is computed without regard to deductions for depreciation, amortization or depletion. Any business interest disallowed may be carried forward indefinitely. This limitation does not apply to small businesses with gross receipts that do not exceed $25 million and certain regulated public utilities. Real estate businesses are permitted to elect out of the application of the limitation, in which case their real property will be subject to depreciation under the ADS.
- **Like-Kind Exchanges**. Like-kind exchange treatment is limited to exchanges of real property used in a trade or business or held for investment (rather than also applying to any property used in a trade or business or held for investment).

Also included in the law are parameters relating to:

- Limitation on employer's deduction for entertainment and fringe benefit expenses.
- Certain contributions to capital included in gross income.
- Limitation on excess employee compensation.

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