GROSSMAN YANAK & FORD LLP

Certified Public Accountants and Consultants

TAX ALERT

TO: Our Clients and Friends

FROM: Grossman Yanak & Ford LLP

DATE: December 22, 2017

REGARDING: Tax Cuts and Jobs Act (H.R. 1)

TAX REFORM PACKAGE SIGNED INTO LAW

After weeks of tumult and vagaries, the new $1.5 Trillion Tax Reform package has been signed into law by President Trump, who has met his well-publicized goal of signing the legislation into law by the Christmas holiday.

Unlike the last major tax reform package enacted into law in 1986, this new tax legislation has proceeded completely along party lines at an unprecedented pace. Few, if any, Democratic additions and/or deletions were incorporated into the final bill, leaving the proposal almost wholly a Republican package.

Much ado has been made of the specifics of the bill with opinions from both sides of the aisle putting forth their interpretations as to which taxpayers most will benefit most from the new provisions. Time will tell who the true winners and losers are, as analysts break down the 500-plus-page tax bill to attain a better and more articulate understanding of the new law.

One thing that is known, however, is that the process by which the bill moved through the House and the Senate, and then through the Conference Committee, has eliminated any real change in the level of complexity of the tax laws. While certain aspects are somewhat simpler than before, enough new provisions have been added to fully offset the simplification provisions. As a result, it is unlikely that anyone other than the simplest Form W-2 employee with no other tax items could file the much-promoted "postcard return."

The final version of the Tax Cuts and Jobs Act (H.R.1) was agreed to by a Congressional Conference Committee on December 15, 2017. The full text of the Conference Report can be found at: https://www.congress.gov/115/crpt/hrpt466/CRPT-115hrpt466.pdf

The House approved the bill on December 19, 2017, by a vote of 227-203, largely along party lines. The Senate vote occurred just before 1:00 am on December 20, 2017, with a positive vote of 51-48. Not a single Democrat voted for the new law. However, because the measure that had been approved earlier by the House vote did not meet certain technical and parliamentary procedures required by the Senate, another House vote was required on December 20. The amended bill was again passed by a vote of 224-201. The final legislation then moved to the President's desk for signature into law, which was completed on December 22, before he left for the Christmas holiday. Most provisions in the bill are scheduled to take effect in 2018.

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Summary of the Final Tax Bill

The final tax bill represents a compromise between the House and Senate versions (see our website posts and prior tax alerts for details). To that end, the final tax reform package accomplishes the following:

- Reduces the corporate tax rate to 21%, effective in 2018
  - *The House and Senate bills had both lowered the rate to 20%, but the original Senate bill had postponed that reduction until 2019*
- Permanently repeals the corporate alternative minimum tax (AMT)
- Reduces the highest individual tax rate to 37%
  - *The House bill kept the top rate at 39.6%, while the Senate bill had reduced it to 38.5%*
- Retains the AMT for individuals, however, the exemption amount increases so fewer taxpayers will be subject to the tax
- Nearly doubles the standard deduction, from $6,500 for individuals and $13,000 for families under current law to $12,000 and $24,000, respectively
  - *Both the original House and Senate bills had proposed such a change*
- Increases the child tax credit to $2,000, with up to $1,400 refundable
- Reduces the deduction amount allowed for mortgage interest to maximum mortgage loans of $750,000
  - *The current-law limit is $1 million – the House bill had proposed to cut this threshold in half, to $500,000, while the Senate bill proposed to keep the $1 million limit*
  - *Note that the $750,000 limit is effective for new mortgages obtained after December 31, 2017*
- Importantly, adds a provision to allow a 20% deduction for pass-through business entity income (under current law, pass-through income is taxed at the individual's marginal tax rate)
  - *The Senate bill had included a 23% deduction, while the House bill had taken a different tact, proposing to set a maximum 25% tax rate on pass-through income with adjustment for earned income*
  - *It is important to note that there are certain limitations on the applicability of the 20% deduction*
- Retains the individual taxpayer deduction for amounts paid (up to $10,000) in state and local income or property taxes
  - *Both the House and Senate proposals provided for elimination of the state and local income tax deduction, while allowing a deduction for real estate taxes up to a maximum of $10,000*
  - *The Conference Committee discussions resulted in a "combined" deduction, allowing taxpayers to deduct either real estate taxes or state and local income taxes, or some combination thereof, up to a maximum of $10,000*
- Doubles the estate tax exemption to $11.2 million (indexed for inflation)

Additional details about the main provisions of the bill are included in the following sections.

Changes for Individual Taxpayers

In order to comply with Senate budget rules that restrict the total cost of the bill, all of the changes affecting individuals will expire after 2025. If no additional acts are passed at that time to extend them, the individual tax provisions would sunset, and the tax law would revert to its current state.

INDIVIDUAL TAX RATES

Despite a proposal in the House bill to reduce the number of brackets, seven tax brackets remain (the same number as under current law). However, the rates and thresholds have changed as a result of Conference Committee discussions. The bottom rate remains at 10%, but the top marginal income tax rate for individuals has been reduced to 37% in the final bill. Marginal income tax rates for brackets in between the lowest and highest have been reduced slightly.

For tax years 2018 through 2025, the following rates would apply to individual taxpayers:

Single Taxpayers

Taxable income over	But not over	Is taxed at
$0	$9,525	10%
$9,525	$38,700	12%
$38,700	$82,500	22%
$82,500	$157,500	24%
$157,500	$200,000	32%
$200,000	$500,000	35%
$500,000		37%

Heads of Households

Taxable income over	But not over	Is taxed at
$0	$13,600	10%
$13,600	$51,800	12%
$51,800	$82,500	22%
$82,500	$157,500	24%
$157,500	$200,000	32%
$200,000	$500,000	35%
$500,000		37%

Married Taxpayers Filing Jointly and Surviving Spouses

Taxable income over	But not over	Is taxed at
$0	$19,050	10%
$19,050	$77,400	12%
$77,400	$165,000	22%
$165,000	$315,000	24%
$315,000	$400,000	32%
$400,000	$600,000	35%
$600,000		37%

Married Taxpayers Filing Separately

Taxable income over	But not over	Is taxed at
$0	$9,525	10%
$9,525	$38,700	12%
$38,700	$82,500	22%
$82,500	$157,500	24%
$157,500	$200,000	32%
$200,000	$300,000	35%
$300,000		37%

Estates and Trusts

Taxable income over	But not over	Is taxed at
$0	$2,550	10%
$2,550	$9,150	24%
$9,150	$12,500	35%
$12,500	$315,000	37%

ALTERNATIVE MINIMUM TAX (AMT)

Though the House bill proposed a complete and permanent repeal of the alternative minimum tax (AMT) for individuals as well as for corporations, the result of the Conference Committee discussion was a retention of the AMT for individuals in the final bill. However, to lessen the sting of this parallel filing system, the exemption amount is increased. Thus, the AMT should affect far fewer taxpayers beginning in 2018.

For calendar years 2018 through 2025, the AMT exemption amount increases to $109,400 for married taxpayers filing jointly (half this amount for married taxpayers filing separately) and to $70,300 for all other taxpayers (other than estates and trusts). Phaseout thresholds increase to $1 million for married taxpayers filing a joint return and to $500,000 for all other taxpayers (other than estates and trusts). The exemption and threshold amounts will be indexed in the future for inflation.

INDIVIDUAL MANDATE

The final legislation repeals the previous penalty imposed (as part of the Affordable Care Act) on taxpayers who do not obtain health insurance. This provision does not take effect until 2019.

DEDUCTIONS AND EXEMPTIONS

Standard Deduction

Much discussed within the media, the standard deduction for individual taxpayers is nearly doubled to $24,000 for married taxpayers filing jointly, $18,000 for heads of households and $12,000 for all other individuals. The additional standard deduction for elderly and blind taxpayers is not changed by the bill. This increase is effective through 2025.

Personal Exemptions

In an effort to simplify taxes, all personal exemptions are repealed through 2025. The benefits lost from this change should be somewhat offset by the increase in the standard deduction. Moreover, the loss of exemptions for dependents should be offset by the expanded child tax credit, discussed below.

Deduction for Pass-Through Income

An important change in the way pass-through business entities are taxed provides owners of such entities *with operating businesses* a tax break to correspond with the reduction in the proposed regular corporation rate structure.

This provision is effective in 2018, but expires after 2025. Under the new law, individual taxpayers are permitted to take a tax deduction equal to 20% of “qualified business income” from a partnership, S corporation or sole proprietorship, subject to certain income threshold limitations. Additionally, 20% of qualified real estate investment trust (REIT) dividends, qualified cooperative dividends (special rules apply to certain agricultural or horticultural cooperatives), and qualified publicly traded partnership income can be deducted from the individual’s taxable income.

For these purposes, qualified business income would mean the "net" amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. These items must be effectively connected with the conduct of a trade or business within the United States. They do not include specified investment-related income, deductions, or losses. Also excluded is an S corporation shareholder's reasonable compensation, guaranteed payments, or payments to a partner who is acting in a capacity other than his or her capacity as a partner, to the extent provided in the Treasury regulations.

The deduction is disallowed for "specified service trades or businesses" with income above a certain threshold. This applies to any trade or business in the fields of accounting, health, law, consulting, athletics, financial services, brokerage services or any business where the principal asset of the business is the reputation or skill of one or more of its employees.

The exclusion from the definition of a qualified business for specified service trades or businesses phases in for a taxpayer with taxable income in excess of $157,500, or $315,000 in the case of a joint return.

For each qualified trade or business, the taxpayer can deduct 20% of the qualified business income with respect to such trade or business. Generally, the deduction is limited to 50% of the W-2 wages paid with respect to the business. Capital-intensive businesses may prefer to use a rule that takes into consideration 25% of wages paid plus a portion of the business's basis in its tangible assets. However, the deductible amount is equal to 20% of the qualified business income with respect to each respective trade or business, if the taxpayer's income is below the threshold amount.

ITEMIZED DEDUCTIONS

The final bill repeals (through 2025) the overall limitation on itemized deductions. Additional provisions related to specific deductions are as follows:

Mortgage Interest

The deduction for home mortgage interest is reduced from $1 million acquisition of indebtedness (under current law) to $750,000. A taxpayer who entered into a binding written contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases that residence before April 1, 2018, will be considered to have incurred acquisition indebtedness prior to December 15, 2017, and will be allowed the current $1 million limit.

Home Equity Loans

The home equity loan interest deduction is repealed through 2025.

State and Local Taxes (SALT)

Individual taxpayers can deduct up to $10,000 ($5,000 for married taxpayers filing separately) in state and local income and/or property taxes. The bill specifically sets out a provision limiting the deduction to 2017 state and local income taxes and does not allow for prepaid 2018 state and local income taxes.

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Casualty Losses

A deduction for casualty losses is only allowed if the loss is attributable to a presidentially declared disaster.

Gambling Losses

The term "losses from wagering transactions" in is modified to include any otherwise allowable deduction incurred in carrying on a wagering transaction. The intention is to clarify that the limitation of losses from wagering transactions applies not only to the actual costs of wagers, but also to other expenses incurred by the taxpayer in connection with his or her gambling activity.

Charitable Contributions

The income-based percentage limit for charitable contributions of cash to public charities is raised to 60%. Payments made for college athletic event seating rights are excluded from deduction as a charitable contribution. A current-law provision that provides an exception to the contemporaneous written acknowledgment requirement for certain contributions that are reported on the donee organization's return is repealed. As such, all future charitable contributions in excess of $250 per annum require a written acknowledgement to ensure deductibility.

Miscellaneous Itemized Deductions

All miscellaneous itemized deductions subject to the 2% floor under current law are repealed through 2025.

Medical Expenses

The threshold for deduction of medical expenses is reduced to from the current level of 10% to 7.5% of adjusted gross income for 2017 and 2018.

INDIVIDUAL TAX CREDITS

Child Tax Credit

The amount of the child tax credit increases to $2,000 per qualifying child, with a maximum refundable amount of $1,400. Additionally, a new, nonrefundable $500 credit is created for qualifying dependents who are not qualifying children. The phase-out threshold for the credit increased to $400,000 for married taxpayers filing jointly, and $200,000 for other taxpayers.

Other Credits

Several credits that would have been repealed by the House version of the bill have been kept in the final bill. These credits include the Section 22 credit for the elderly and permanently disabled; the Section 30D credit for plug-in electric drive motor vehicles; and the Section 25 credit for interest on certain home mortgages.

The House bill's earlier-proposed modifications to the American Opportunity Tax Credit and Lifetime Learning Credit also were not included the final bill.

RETIREMENT PLANNING

Recharacterization of IRAs

Conversion contributions to Roth IRAs are excluded from the rule that allows IRA contributions to one type of IRA to be recharacterized as a contribution to the other type of IRA.

ESTATE PLANNING

Estate, Gift and Generation-Skipping Transfer Taxes

The estate and gift tax exemption is doubled from $5.6 million to $11.2 million from per individual. This provision applies to estates and gifts for the tax years 2018 through 2025. The exclusion amount will be indexed for inflation.

The final bill does not include any changes to the tax basis rules allowed under Section 1014 for property received from a decedent. Thus, property received at the death of another will carry a tax basis equal to its fair market value at the date of death.

EDUCATION-RELATED PROVISIONS

Section 529 Plan Distributions

The provisions for Section 529 plans are modified to allow distributions for tuition expenses (under $10,000 per tax year) incurred for an elementary or secondary school. This limitation applies on a per-student basis, rather than a per-account basis. A provision that would have allowed certain home school expenses to also qualify as eligible expenses for purposes of the Section 529 rules was removed before the final Senate vote.

Student Loans

The exclusion of student loan discharges from gross income is modified to include certain discharges on account of death or disability. Though a repeal of the student loan interest deduction was proposed in the House bill, the final legislation retains it.

Tuition Waivers

The deduction for qualified tuition and related expenses remains, despite proposed repeal in the House bill.

Savings Bonds

Current-law exclusions for interest on Series EE savings bond used for qualified higher education expenses and for educational assistance programs remain in effect, despite the repeal proposed by the House bill.

OTHER CURRENT PROVISIONS – REPEALED

Alimony Payments

Current-law provisions regarding alimony and separate maintenance payments are repealed for any divorce or separation agreement executed *after* December 31, 2018. Such payments cannot be deducted from income by the payor spouse and cannot be included in income by the payee spouse.

Moving Expenses

The deduction for moving expenses and the exclusion from gross income and wages for qualified moving expense reimbursements are eliminated through 2025. Exceptions are made for members of the armed forces on active duty who move pursuant to a military order.

Bicycle Commuting Expenses

Qualified bicycle commuting expenses can no longer be excluded from gross income, through 2025.

OTHER CURRENT PROVISIONS – RETAINED

Archer Medical Savings Accounts (MSAs)

Deductions remain for contributions to these medical savings accounts often used by small businesses or self-employed individuals. The House bill included a proposed repeal of this provision.

Educator's Classroom Expenses

The current-law allowance of an above-the-line $250 deduction can still be taken for educators' expenses incurred for professional development or to purchase classroom materials.

Sale of a Principal Residence

The current rules remain in effect regarding exclusion of gain from the sale of a principal residence.

Changes for Corporate Taxpayers

At the heart of the tax package is corporate tax reform, and the Congressional and Presidential motivation to make America's operating environment more comparable with the rest of the industrialized world, and by doing so, to enhance the competitive viability of operating within the borders of the United States. The bill goes a long way in meeting these goals.

Unlike the individual provisions discussed above, the bill provides permanent changes to benefit corporate taxpayers, again, with the intention to stimulate the economy, level the playing field for U.S. corporations competing in an international economy and encourage U.S. businesses to keep more operations in the United States.

The taxpayer-friendly provisions include a significant reduction to the corporate tax rate, favorable changes to corporate deductions and tax credits, and a switch to a territorial tax system for companies that earn income outside of the United States.

CORPORATE TAX RATES

Though a bit higher than the 20% top marginal income tax originally proposed by both the House and Senate bills, the compromise flat marginal income tax rate of 21% is still a significant reduction from the current graduated corporate tax rate, which taxes income over $10 million at 35%. This decrease take effect immediately (in 2018), despite the earlier proposal in the Senate bill to delay the start of the lowered corporate rate until 2019.

It is noteworthy that a special 25% rate on personal service corporations, which was proposed in the House bill, was eliminated in the final Conference Committee version.

ALTERNATIVE MINIMUM TAX (AMT)

The AMT is permanently repealed for corporations. Bills from both chambers included this repeal provision.

EXPENSING AND DEPRECIATION

Section 179 Expensing

The maximum amount that can be expensed under the Section 179 rules is increased to $1 million, and the phaseout threshold is increased to $2.5 million. These amounts would be indexed for inflation after 2018.

The final legislation also expands the definition of Section 179 property to include certain depreciable tangible personal property "used predominantly to furnish lodging or in connection with furnishing lodging". The definition of "qualified real property" eligible for Section 179 expensing is expanded to include any of the following improvements to nonresidential real property: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Bonus Depreciation

Bonus depreciation allowed under the current law is expanded to permit businesses to immediately write off the full cost of eligible property in the year it is placed in service, through 2022. However, after 2022, the provision will begin to phase down: 80% would be allowed for property placed in service in 2023, 60% in 2024, 40% in 2025, and 20% in 2026. For certain property with long production periods, the above dates would be extended one year.

Interestingly, the bill also eliminates the requirement that only new property is eligible for bonus depreciation. The implications of this change are broad. For example, by statute, it appears that the entire cost of eligible depreciable property in a business acquisition through a purchase of assets can be expensed in a single year.

Luxury Auto Depreciation Limits

The depreciation limits under Section 280F that apply to listed property, for which bonus depreciation is not claimed, are increased. For passenger automobiles placed in service after 2017, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years.

CHANGES TO DEDUCTIONS

Business Interest Deduction Limitation

A significant proposed change in the final legislation limits the deduction for business interest to the sum of (1) business interest income; (2) 30% of the taxpayer's adjusted taxable income for the tax year; and (3) the taxpayer's floor plan financing interest for the tax year. Any disallowed business interest deduction could be carried forward indefinitely (with certain restrictions for partnerships).

Again, consideration of this provision requires careful attention to definitions:

Business interest – any interest paid or accrued on indebtedness properly allocable to a trade or business. It does not include investment interest, and business interest income does not include investment income.

Business interest income – the amount of interest includible in the taxpayer's gross income for the tax year that is properly allocable to a trade or business.

Business interest floor plan financing interest – interest paid or accrued on indebtedness used to finance the acquisition of motor vehicles held for sale or lease to retail customers and secured by the inventory so acquired.

The law does include several exemptions for smaller corporations and real property and farming businesses. Any taxpayer that meets the $25 million gross-receipts test will be exempt from the limitation on the interest deduction. The limitation also does not apply to any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. Farming businesses can elect out of the limitation.

Net Operating Losses (NOLs)

For net operating losses (NOLs) generated in 2018 and forward, the deduction is limited to 80% of taxable income (determined without regard to the deduction) for losses. Property and casualty insurance companies are exempt from this limitation.

NOLs can be carried forward indefinitely. The bill repeals the two-year carryback and special NOL carryback provisions, but, farming businesses would still be allowed a two-year NOL carryback.

Domestic Production Activities Deduction

The Section 199 domestic production activities deduction is repealed.

Like-Kind Exchanges

Like-kind exchanges allowed under Section 1031 are limited to exchanges of real property that is not primarily held for sale. This provision generally applies to exchanges completed after December 31, 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received on or before that date.

Food and Beverage Expenses

Generally, taxpayers will still be permitted to deduct 50% of the food and beverage expenses associated with operating their trade or business, which includes meals consumed by employees on work travel. For amounts incurred and paid after December 31, 2017, and until December 31, 2025, the 50% limitation is expanded to include employer expenses associated with providing food and beverages to employees through an eating facility that meets requirements for de minimis fringes and for the convenience of the employer. Such amounts incurred and paid after December 31, 2025, will not be deductible.

Entertainment Expenses

The deduction for entertainment expenses is now disallowed with respect to: (1) an activity generally considered to be entertainment, amusement, or recreation; (2) membership dues with respect to any club organized for business, pleasure, recreation, or other social purposes; or (3) a facility or portion thereof used in connection with any of the above items.

Qualified Transportation Fringe Benefits Expenses

The deduction is disallowed for expenses associated with providing any qualified transportation fringe to employees of the taxpayer, and except as necessary for ensuring the safety of an employee, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment.

CHANGES TO BUSINESS CREDITS

The final legislation includes many business credits that were proposed for repeal under the House bill. However, the Conference Committee discussions added just the following modifications to the current-law provisions.

Orphan Drug Credit

The Section 45C credit for clinical testing expenses for drugs for rare diseases or conditions is cut in half (from the current rate of 50% to 25%).

Rehabilitation Credit

The Section 47 rehabilitation credit is modified by the legislation. The 10% credit for pre-1936 buildings is repealed, but the 20% credit for certified historic structures is retained. The credit is claimed over a five-year period.

Employer Credit for Paid Family/Medical Leave

Eligible employers are permitted to claim a credit equal to 12.5% of the amount of wages paid to a qualifying employee during any period in which the employee is on family and medical leave, if the rate of payment under the program is 50% of the wages normally paid to the employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.

The maximum amount of family and medical leave that may be taken into account with respect to any employee for any tax year is 12 weeks. This credit will only be available in 2018 and 2019.

OTHER BUSINESS CHANGES

Technical Terminations of Partnerships

The rule providing for technical terminations of partnerships under specified circumstances is repealed by the new legislation. However, the current-law rule remains in effect, specifying that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

Carried Interest

The legislation establishes a three-year holding period in the case of certain net long-term capital gain with respect to any applicable partnership interest held by the taxpayer. Under these provisions, the amount of a taxpayer's net long-term capital gain with respect to an applicable partnership interest, if the partnership interest has been held for less than three years, would be treated as short-term capital gain taxed at ordinary income rates.

This three-year holding requirement applies notwithstanding the rules of Section 83 or any election in effect under Section 83(b).

Research and Experimental Expenditures

Amounts defined as specified research or experimental expenditures must be capitalized and amortized ratably over a five-year period. Specified research or experimental expenditures that are attributable to research conducted outside of the United States must be capitalized and amortized ratably over a 15-year period.

Year of Inclusion

Under the new bill, accrual-method taxpayers subject to the all-events test are required to recognize items of gross income for tax purposes in the year in which they recognize the income on their applicable financial statement (or another financial statement under rules to be specified by the IRS). Taxpayers without an applicable or other specified financial statement are excepted from the rule.

COMPENSATION-RELATED CHANGES

Covered Employees (Publicly Traded Corporations)

Under current law, Section 162(m) limits the deductibility of compensation paid to certain "covered employees" of publicly-traded corporations, which are defined as the chief executive officer and the four most highly compensated officers (other than the CEO).

The definition of a covered employee under Section 162(m) is modified by the bill.

The revised definition includes both the principal executive officer and the principal financial officer and reduces the number of other officers included to the three most highly compensated officers for the tax year. The final bill also requires that if an individual is a covered employee for any tax year (after 2016), that individual will remain a covered employee for all future years. Current-law exceptions for commissions and performance-based compensation are removed under the new legislation.

Additionally, the bill includes a transition rule so that the proposed changes would not apply to any remuneration under a written binding contract that was in effect on November 2, 2017, and that was not later modified in any material respect.

Qualified Equity Grants

Under the new legislation, a qualified employee is permitted to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer.

An election to defer income inclusion with respect to qualified stock must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

CHANGES TO CASH METHOD OF ACCOUNTING RULES

The final bill makes a variety of changes to the rules governing the use of cash-basis accounting. These rules generally relax the limitations on adopting this basis of accounting and the change is certain to expand the number of business taxpayers using cash-basis accounting in the future.

Expanded Eligibility

The bill expands eligibility to use the cash method to include taxpayers that have average annual gross receipts of $25 million or less in the three prior tax years. The $25 million gross-receipts threshold will be indexed for inflation after 2018.

The legislation allows the cash method of accounting to be used by taxpayers, other than tax shelters, that satisfy the gross-receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor.

Farming C corporations (or farming partnerships with a C corporation partner) are allowed to use the cash method if they meet the $25 million gross-receipts test.

The current-law exceptions from the use of the accrual method would otherwise remain the same, so qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities would continue to be allowed to use the cash method without regard to whether they meet the $25 million gross-receipts test, so long as the use of such method clearly reflects income.

Additional Exemptions

Taxpayers that meet the cash method $25 million gross-receipts test would be exempted from additional requirements:

Inventories – Qualified taxpayers are required to account for inventories under Section 471 and allowed to use an accounting method that either treats inventories as non-incidental materials and supplies or conforms to their financial accounting treatment of inventories.

UNICAP – Qualified taxpayers do not need to comply with the uniform capitalization rules of Section 263A. (Current-law exemptions from the UNICAP rules that are not based on gross receipts also still apply.)

TAXATION OF FOREIGN INCOME

The new set of international rules was designed to move the United States from its current worldwide system of taxation to a territorial tax system, in which only domestic profits would be taxed. The process and plan for doing such manifests itself in a number of ways, many of which are outlined below. Additionally, the decrease in the tax rates would place the United States in the middle of the pack in comparison to other OECD countries and, thus, make the country more competitive with other, similar developed nations.

Deduction for Foreign-Sourced Dividend Income

The legislation allows a 100% deduction for the foreign-source portion of dividends received from "specified 10%-owned foreign corporations" by domestic corporations that are U.S. shareholders of those foreign corporations.

In interpreting this provision, it is important to respect the intended definitions of key concepts:

Dividend received – This term is intended to be interpreted broadly, consistently with the meaning of the phrases "amount received as dividends" and "dividends received" under Sections 243 and 245, respectively.

Specified 10%-owned foreign corporation – means any foreign corporation, other than a passive foreign investment company (PFIC) that is not also a controlled foreign corporation (CFC), with respect to which any domestic corporation is a U.S. shareholder.

Limitations:

Hybrid dividends – The deduction is not available for any dividend received by a U.S. shareholder from a CFC if the dividend is a "hybrid dividend." A hybrid dividend is an amount received from a CFC for which a deduction would be allowed under this provision and for which the specified 10%-owned foreign corporation received a deduction (or other tax benefit) from any income, war profits, and excess profits taxes imposed by a foreign country.

Foreign Tax Credit – No foreign tax credit or deduction would be allowed for any taxes paid or accrued with respect to a dividend that qualifies for the deduction.

Holding Period – A domestic corporation would not be permitted a deduction in respect of any dividend on any share of stock that is held by the domestic corporation for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend.

Repatriation of Foreign Income

Under the new legislation, any U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the accumulated post-1986 deferred foreign income of the corporation, for the last tax year beginning before January 1, 2018. A "specified foreign corporation" is any foreign corporation in which a U.S. person owns a 10% voting interest. It excludes PFICs that are not also CFCs.

A portion of that pro rata share of foreign earnings is deductible, with the deductible amount varying, based on whether the deferred earnings are held in cash or other assets. The deduction results in a reduced rate of tax (15.5% for cash and cash equivalents and 8% for all other earnings) with respect to income from the required inclusion of pre-effective-date earnings. A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The separate foreign tax credit limitation rules of current-law Section 904 apply, with coordinating rules. The increased tax liability generally may be paid over an eight-year period. Special rules are provided for S corporations and real estate investment trusts (REITs).

Foreign Intangible Income

The bill provides domestic C corporations (that are not regulated investment companies or REITs) with a reduced tax rate on "foreign-derived intangible income" (FDII) and "global intangible low-taxed income" (GILTI). FDII is the portion of a domestic corporation's intangible income that is derived from serving foreign markets, using a formula in a new Section 250. GILTI would be defined in a new Section 951A.

The effective tax rate on FDII will be 13.125% in tax years beginning after 2017 and before 2026, and 16.406% after 2025. The effective tax rate on GILTI will be 10.5% in tax years beginning after 2017 and before 2026 and 13.125% after 2025.

U.S. Shareholder Definition

The ownership attribution rules of Section 958(b) are modified to expand the definition of "U.S. shareholder" to include a U.S. person who owns at least 10% of the value of the shares of the foreign corporation.

CONCLUDING THOUGHTS

Certainly, as more of the committee report details are released from both the House and the Senate, as well as from the Conference Committee where the two bills were reconciled into a single final tax bill, more information will shed light on Congressional intent and the specific details of each provision. Such information will allow us to better interpret the reach of each of the new provisions and determine how best to incorporate the new law into the tax planning regimes of our clients.

Grossman Yanak & Ford LLP will continue to monitor and report on the bill's developments and to bring any major changes to the attention of our clients and friends through additional website posts, emails and tax alerts. In addition, Grossman Yanak & Ford LLP will be providing several client seminars on the new tax laws after the beginning of the year. The dates, locations and details will be posted on our website at www.gyf.com.

If you have questions or comments, please contact Bob Grossman or Don Johnston at 412-338-9300