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Tax Cuts & Jobs Act: Overview of Key Provisions Affecting Business Taxpayers

(Unless otherwise noted, the changes are effective for tax years beginning in 2018)

- **New Deduction for Pass-Through Income** – The new law establishes a 20 percent deduction for "qualified business income" from certain pass-through businesses (i.e. partnerships, S-Corporations, LLC's or sole proprietorships). Specific services, such as health, law and professional services, are generally excluded. However, joint filers with taxable income below $315,000 (deduction phased-out fully at $415,000) and other filers with taxable income below $157,500 (deduction phased-out fully at $207,500) can claim the deduction on income from specified service industries. Additionally, for taxpayers with taxable income more than the above thresholds, a limitation on the amount of the deduction is phased in based on either wages paid or wages paid plus a capital element.

- **Corporate Tax Rates Reduced** – The graduated corporate tax rates of 15%, 25%, 34% and 35% are replaced with a single flat rate of 21%.

- **Corporate Alternative Minimum Tax Repealed** – For tax years beginning after Dec. 31, 2017, the corporate Alternative Minimum Tax is repealed.

- **Increased Section 179 Expensing** – Code Sec. 179 expensing, which allows a taxpayer to immediately deduct the cost of qualifying property, is increased to a maximum of $1 million, and the phase-out threshold is increased to $2.5 million. Both the $1 million and the $2.5 million amounts are indexed for inflation. The expense election has also been expanded to cover (1) certain depreciable tangible personal property used mostly to furnish lodging or in connection with furnishing lodging, and (2) the following improvements to nonresidential real property made after it was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; security systems; and any other building improvements that aren't elevators or escalators, don't enlarge the building, and aren't attributable to internal structural framework.

- **100% Expensing of Qualified Business Assets** – A 100% depreciation expensing of qualifying business assets acquired and placed in service after Sept. 27, 2017 and before Jan. 1, 2023. The additional first-year depreciation deduction is allowed for both new and used property. This provision replaces the previous 50% bonus depreciation available for qualified new property.

- **Depreciation of Qualified Improvement Property** – The new law provides that qualified improvement property is depreciable using a 15-year recovery period and the straight-line method. Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property placed in service after the building was placed in service. It does not include expenses related to the enlargement of the building, any elevator or escalator, or the internal structural framework. There are no longer separate requirements for leasehold improvement property or restaurant property.

- **Limits on Deduction of Business Interest** – For tax years beginning after Dec. 31, 2017, every business, regardless of its form, is generally subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. Adjusted taxable income is computed without regard to deductions for depreciation, amortization, or depletion. 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. Any business interest disallowed under this rule is carried forward into the following year, and, generally may be carried forward indefinitely. An exemption for these new rules applies for taxpayers with average annual gross receipts of under $25 million for a three-year tax period ending with the prior tax year. Real property trades or businesses can elect to have the rule not apply if they elect to use the alternative depreciation system for real property used in their trade or business.

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- **Modification of Net Operating Loss Deduction** – The net operating loss (NOL) deduction is modified with the repeal of the two-year carryback and other special carryback provisions, though the two-year carryback still applies in the case of certain farming losses. For losses arising after Dec. 31, 2017, the deduction is limited to 80% of taxable income. Carryovers to other years are adjusted to take account of the 80% limitation, and NOLs can be carried forward indefinitely rather than expiring after 20 years.

- **Partnership Technical Termination Rule Repealed** – The new law repeals the partnership "technical termination" rule whereby a partnership is terminated for tax purposes if within a 12-month period, there is a sale or exchange of 50% or more of total partnership capital and profits interests.

- **DPAD** – The Domestic Production Activities Deduction (DPAD) is repealed for tax years beginning after 2017.

- **New Fringe Benefit Rules** – The new law eliminates the 50% deduction for business-related entertainment expenses. The pre-Act 50% limit on deductible business meals is expanded to cover meals provided for the convenience of the employer (previously 100% deductible). Additionally, the deduction for transportation fringe benefits (e.g. parking and mass transit) is denied to employers, but the exclusion from income for such benefits for employees continues.

- **Family and Medical Leave Credit** – A new general business credit is available for tax years beginning in 2018 and 2019 for eligible employers equal to 12.5% of wages they pay to qualifying employees on family and medical leave if the rate of payment is 50% of wages normally paid to the employee. The credit increases by 0.25% (up to a maximum of 25%) for each percent by which the payment rate exceeds 50% of normal wages. For this purpose, the maximum leave that may be taken into account for any employee for any year is 12 weeks. Eligible employers are those with a written policy in place allowing qualifying full-time employees at least two weeks of paid family and medical leave a year, and less than full-time employees a pro-rated amount of leave. A qualifying employee is one who has been employed by the employer for one year or more and who, in the preceding year, had compensation not above 60% of the compensation threshold for highly compensated employees. Paid leave provided as vacation leave, personal leave, or other medical or sick leave is not considered family and medical leave.

- **Like-Kind Exchange Treatment Limited** – The rule allowing the deferral of gain on like-kind exchanges is modified to allow them only with respect to real property that is not held primarily for sale. It can still apply to exchanges of personal property if the taxpayer has disposed of the relinquished property or acquired the replacement property by Dec. 31, 2017.

- **Cash Method of Accounting** – Expanded use of the cash method of accounting for taxpayers that satisfy a $25 million gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations are retained. Accordingly, qualified personal service corporations, partnerships without C corporation partners, S Corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of the method clearly reflects income.

- **Accounting for Long-Term Contracts** – For contracts entered into after December 31, 2017 in tax years ending after that date, the exception for small construction contracts from the requirement to use the percentage of completion method is expanded to apply to contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the tax year in which the contract was entered into) meets the $25 million gross receipts test.

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