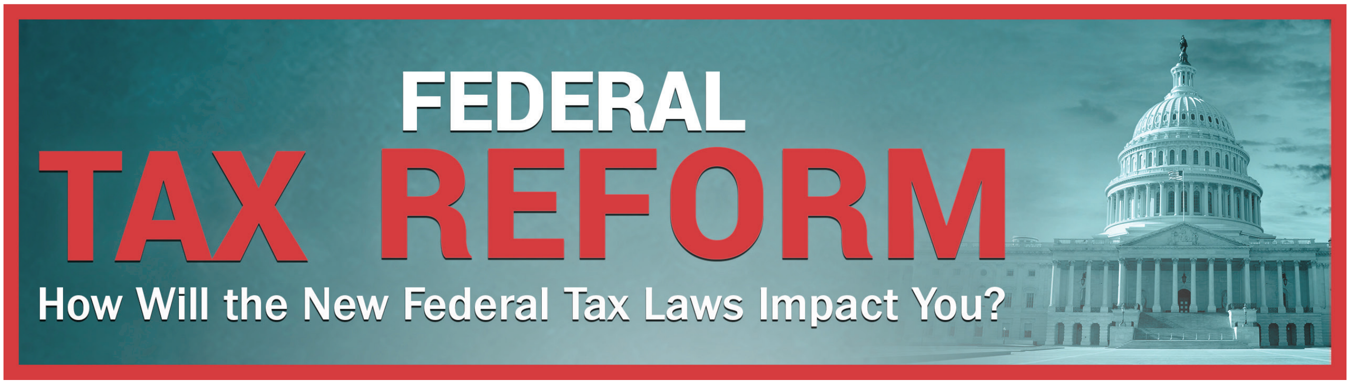
Bowles Rice
ATTORNEYS AT LAW

Important Information from the Bowles Rice Tax Team



Overview of the Business Tax Changes in the Tax Cuts and Jobs Act

The recently enacted Tax Cuts and Jobs Act ("TCJA") is a sweeping tax package. Here's an overview of some of the more important business tax changes in the new law. Unless otherwise noted, the changes are effective for tax years beginning in 2018.

Corporate tax rates reduced. One of the more significant new law provisions cuts the corporate tax rate to a flat 21%. Before the new law, rates were graduated, starting at 15% for taxable income up to $50,000, with rates at 25% for income between 50,001 and $75,000, 34% for income between $75,001 and $10 million, and 35% for income above $10 million.

Dividends-received deduction. The dividends-received deduction available to corporations that receive dividends from other corporations has been reduced under the new law. For corporations owning at least 20% of the dividend-paying company, the dividends-received deduction has been reduced from 80% to 65% of the dividends. For corporations owning under 20%, the deduction is reduced from 70% to 50%.

Alternative minimum tax repealed for corporations. The corporate alternative minimum tax (AMT) has been repealed by the new law.

Alternative minimum tax credit. Corporations are allowed to offset their regular tax liability by the AMT credit. For tax years beginning after 2017 and before 2022, the credit is refundable in an amount equal to 50% (100% for years beginning in 2021) of the excess of the AMT credit for the year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the credit will be allowed in tax years beginning before 2022.

Net Operating Loss ("NOL") deduction modified. Under the new law, generally, NOLs arising in tax years ending after 2017 can only be carried forward, not back. The general two-year carryback rule, and other special carryback provisions, have been repealed. However, a two-year carryback for certain farming losses is allowed. These NOLs can be carried forward indefinitely, rather than expiring after 20 years. Additionally, under the new law, for losses arising in tax years beginning after 2017, the NOL deduction is limited to 80% of taxable income, determined without regard to the deduction. Carryovers to other years are adjusted to take account of the 80% limitation.

Limit on business interest deduction. Under the new law, every business, regardless of its form, is limited to a deduction for business interest equal to 30% of its adjusted taxable income. For pass-through entities such as partnerships and S corporations, the determination is made at the entity, i.e., partnership or S corporation, level. Adjusted taxable income is computed without regard to the repealed domestic production activities deduction and, for tax years beginning after 2017 and before 2022, without regard to deductions for depreciation, amortization, or depletion. Any business interest disallowed under this rule is carried into the following year, and, generally, may be carried forward indefinitely. The limitation does not apply to taxpayers (other than tax shelters) with average annual gross receipts of $25 million or less for the three-year 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. Certain additional rules apply to partnerships.

Domestic production activities deduction ("DPAD") repealed. The new law repeals the DPAD for tax years beginning after 2017. The DPAD formerly allowed taxpayers to deduct 9% (6% for certain oil and gas activities) of the lesser of the taxpayer's (1) qualified production activities income ("QPAI") or (2) taxable income for the year, limited to 50% of the W-2 wages paid by the taxpayer for the year. QPAI was the taxpayer's receipts, minus expenses allocable to the receipts, from property manufactured, produced, grown, or extracted within the U.S.; qualified film productions; production of electricity, natural gas, or potable water; construction activities performed in the U.S.; and certain engineering or architectural services.

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 via an in-house cafeteria or otherwise on the employer's premises. 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. However, bicycle commuting reimbursements are deductible by the employer but not excludable by the employee. Last, no deduction is allowed for transportation expenses that are the equivalent of commuting for employees except as provided for the employee's safety.

Penalties and fines. Under pre-Act law, deductions are not allowed for fines or penalties paid to a government for the violation of any law. Under the new law, no deduction is allowed for any otherwise deductible amount paid or incurred by suit, agreement, or otherwise to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by the government or entity into the potential violation of any law. An exception applies to any payment the taxpayer establishes is either restitution (including remediation of property), or an amount required to come into compliance with any law that was violated or involved in the investigation or inquiry, that is identified in the court order or settlement agreement as such a payment. An exception also applies to an amount paid or incurred as taxes due.

Sexual harassment. Under the new law, effective for amounts paid or incurred after Dec. 22, 2017, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if the payments are subject to a nondisclosure agreement.

Lobbying expenses. The new law disallows deductions for lobbying expenses paid or incurred after the date of enactment with respect to lobbying expenses related to legislation before local governmental bodies (including Indian tribal governments). Under pre-Act law, such expenses were deductible.

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.

Qualified rehabilitation credit. The new law repeals the 10% credit for qualified rehabilitation expenditures for a building that was first placed in service before 1936, and modifies the 20% credit for qualified rehabilitation expenditures for a certified historic structure. The 20% credit is allowable during the five-year period starting with the year the building was placed in service in an amount that is equal to the ratable share for that year. This is 20% of the qualified rehabilitation expenditures for the building, as allocated ratably to each year in the five-year period. It is intended that the sum of the ratable shares for the five years not exceed 100% of the credit for qualified rehabilitation expenditures for the building. The repeal of the 10% credit and modification of the 20% credit take effect starting in 2018 (subject to a transition rule for certain buildings owned or leased at all times after 2017).

Orphan drug credit reduced and modified. The new law reduces the business tax credit for qualified clinical testing expenses for certain drugs for rare diseases or conditions, generally known as “orphan drugs,” from 50% to 25% of qualified clinical testing expenses for tax years beginning after 2017. These are costs incurred to test an orphan drug after it has been approved for human testing by the FDA but before it has been approved for sale. Amounts used in computing this credit are excluded from the computation of the separate research credit. The new law modifies the credit by allowing a taxpayer to elect to take a reduced orphan drug credit in lieu of reducing otherwise allowable deductions.

Increased Code Sec. 179 expensing. The new law increases the maximum amount that may be expensed under Code Sec. 179 to $1 million. If more than $2.5 million of property is placed in service during the year, the $1 million limitation is reduced by the excess over $2.5 million. Both the $1 million and the $2.5 million amounts are indexed for inflation after 2018. 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.

Bonus depreciation. Under the new law, a 100% first-year deduction is allowed for qualified new and used property acquired and placed in service after September 27, 2017 and before 2023. Pre-Act law provided for a 50% allowance, to be phased down for property placed in service after 2017. Under the new law, the 100% allowance is phased down starting after 2023.

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.

Depreciation of farming equipment and machinery. Under the new law, subject to certain exceptions, the cost recovery period for farming equipment and machinery the original use of which begins with the taxpayer is reduced from 7 to 5 years. Additionally, in general, the 200% declining balance method may be used in place of the 150% declining balance method that was required under pre-Act law.

Luxury auto depreciation limits. Under the new law, for a passenger automobile for which bonus depreciation (see above) is not claimed, the maximum depreciation allowance is increased to $10,000 for the year it’s placed in service, $16,000 for the second year, $9,000 for the third year, and $5,760 for the fourth and later years in the recovery period. These amounts are indexed for inflation after 2018. For passenger autos eligible for bonus first year depreciation, the maximum additional first year depreciation allowance remains at $8,000 as under pre-Act law.

Computers and peripheral equipment. The new law removes computers and peripheral equipment from the definition of listed property. Thus, the heightened substantiation requirements and possibly slower cost recovery for listed property no longer apply.

New rules for post-2021 research and experimentation ("R & E") expenses. Under the new law, specified R & E expenses paid or incurred after 2021 in connection with a trade or business must be capitalized and amortized ratably over a 5-year period (15 years if conducted outside the U.S.). These include expenses for software development, but not expenses for land, or depreciable or depletable property used in connection with the R & E (but do include the depreciation and depletion allowance for such property). Under pre-TCJA law, i.e., for R&E expenses paid or incurred before 2022, these expenses are deductible currently or may be capitalized and recovered over the useful life of the research (not to exceed 60 months), or over a ten-year period, at the taxpayer's election.

Like-kind exchange treatment limited. Under the new law, the rule allowing the deferral of gain on like-kind exchanges of property held for productive use in a taxpayer's trade or business or for investment purposes is limited to cover only like-kind exchanges of real property not held primarily for sale. Under a transition rule, the pre-TCJA law applies to exchanges of personal property if the taxpayer has either disposed of the property given up or obtained the replacement property before 2018.

Excessive employee compensation. Under pre-Act law, a deduction for compensation paid or accrued with respect to a covered employee of a publicly traded corporation is deductible only up to $1 million per year. Exceptions applied for commissions, performance-based pay, including stock options, payments to a qualified retirement plan, and amounts excludable from the employee's gross income. The new law repealed the exceptions for commissions and performance-based pay. The definition of "covered employee" is revised to include the principal executive officer, principal financial officer, and the three highest-paid officers. An individual who is a covered employee for a tax year beginning after 2016 remains a covered employee for all future years.

Employee achievement awards clarified. An employee achievement award is tax free to the extent the employer can deduct its cost, generally limited to $400 for one employee or $1,600 for a qualified plan award. An employee achievement award is an item of tangible personal property given to an employee in recognition of length of service or a safety achievement and presented as part of a meaningful presentation. The new law defines "tangible personal property" to exclude cash, cash equivalents, gift cards, gift coupons, gift certificates (other than from an employer pre-selected limited list), vacations, meals, lodging, theater or sports tickets, stocks, bonds, or similar items, and other non-tangible personal property.

QUESTIONS? If you wish to discuss these or other changes, please contact a member of the Bowles Rice Tax Team.

Mike Caryl
(304) 264-4225
mcaryl@bowlesrice.com

Bob Kiss
(304) 347-1736
rkiss@bowlesrice.com

Marc Monteleone
(304) 347-1132
monteleone@bowlesrice.com

Alison Cox
(304) 264-4211
aacox@bowlesrice.com

David DeJarnett
(304) 264-4232
ddejarnett@bowlesrice.com

Emily Lambright
(304) 347-1124
elambright@bowlesrice.com

Kin Sayre
(304) 264-4226
ksayre@bowlesrice.com

Melissa Hall
(724) 514-8942
mhall@bowlesrice.com

Rick Hudson
(304) 420-5511
rhudson@bowlesrice.com

Breck Martin
(304) 420-5506
bmartin@bowlesrice.com

Seth Wilson
(304) 285-2531
swilson@bowlesrice.com

Amy Lamp-Leonard
(304) 264-4235
aleonard@bowlesrice.com