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IV. Business-Related Changes

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IV. Business-Related Changes

Reduction in Corporate Tax Rate
TCJA eliminates the graduated corporate rate structure and instead taxes corporate taxable income at 21 percent. It also eliminates the special tax rate for personal service corporations and repeals the maximum corporate tax rate on net capital gain as obsolete. For taxpayers subject to the normalization method of accounting (e.g., regulated public utilities), TCJA provides for the normalization of excess deferred tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before January 1, 2018).
The provision is effective for tax years beginning after December 31, 2017. (return to Business-Related Changes)

Reduction of Dividends Received Deductions to Reflect Lower Corporate Tax Rate
TCJA reduces the 70 percent dividends received deduction available to corporations who receive a dividend from another taxable domestic corporation to 50 percent. It also reduces the 80 percent dividends received deduction for dividends received from a 20-percent owned corporation to 65 percent. The provision is effective for tax years beginning after December 31, 2018. (return to Business-Related Changes)

Corporate Alternative Minimum Tax
TCJA repeals the corporate alternative minimum tax (AMT).
In the case of a corporation, TCJA allows the AMT credit to offset the regular tax liability for any tax year. In addition, the AMT credit is refundable for any tax year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of tax years beginning in 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability. Thus, the full amount of the minimum tax credit will be allowed in tax years beginning before 2022. The provision is effective for tax years beginning after December 31, 2017. (return to Business-Related Changes)

Enhanced Expensing Through Bonus Depreciation
TCJA extends and modifies the additional first-year (i.e., "bonus") depreciation deduction through 2026 (through 2027 for longer production period property and certain aircraft). Under TCJA, the 50-percent additional depreciation allowance is increased to 100 percent for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023.

The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in tax years beginning after 2022 (after 2023 for longer production period property and certain aircraft). Thus, for property placed in service after December 31, 2022, and before January 1, 2024 (January 1, 2025, for longer production period property and certain aircraft), the bonus percentage is 80 percent; for property placed in service after December 31, 2023, and before January 1, 2025 (January 1, 2026, for longer production period property and certain aircraft), the bonus percentage is 60 percent; for property placed in service after December 31, 2024, and before January 1, 2026 (January 1, 2027, for longer production period property and certain aircraft), the bonus percentage is 40 percent; for property placed in service after December 31, 2025, and before January 1, 2027 (January 1, 2028, for longer production period property and certain aircraft), the bonus percentage is 20 percent. The general bonus depreciation percentages also apply to certain specified plants bearing fruits or nuts.
Observation: Under current law, the bonus depreciation is scheduled to end for qualified property acquired and placed in service before January 1, 2020 (January 1, 2021, for longer production period property and certain aircraft) and the 50-percent bonus depreciation amount is scheduled to be phased down for property placed in service after December 31, 2017, including certain specified plants bearing fruits or nuts planted or grafted after such date. Thus, TCJA repeals the current-law phase-down of the additional first-year depreciation deduction for property placed in service after December 31, 2017, as

well as the phase down also scheduled for certain specified plants bearing fruits or nuts planted or grafted after such date.

TCJA also provides that the present-law phase-down of bonus depreciation is maintained for property acquired before September 28, 2017, and placed in service after September 27, 2017. Under the provision, in the case of property acquired and adjusted basis incurred before September 28, 2017, the bonus depreciation rates are as follows: 50 percent if placed in service in 2017 (2018 for longer production period property and certain aircraft), 40 percent if placed in service in 2018 (2019 for longer production period property and certain aircraft), 30 percent if placed in service in 2019 (2020 for longer production period property and certain aircraft), and zero percent if placed in service in 2020 (2021 for longer production period property and certain aircraft).

TCJA maintains the bonus depreciation increase amount of $8,000 for luxury passenger automobiles placed in service after December 31, 2017.
Observation: Under current law, the $8,000 increase in depreciation for luxury passenger automobiles (as defined in Code Sec. 280F(d)(5)) was scheduled to be phased down to $6,400 and $4,800 for property placed in service in 2018 and 2019, respectively.

As a conforming amendment to the repeal of the corporate AMT, TCJA repeals the election to accelerate corporate AMT credits in lieu of bonus depreciation. TCJA extends the special rule under the percentage-of-completion method for the allocation of bonus depreciation to a long-term contract for property placed in service before January 1, 2027 (January 1, 2028, in the case of longer production period property). Qualified Property. TCJA removes the requirement that, in order to qualify for bonus depreciation, the original use of qualified property must begin with the taxpayer. Thus, the provision applies to purchases of used as well as new items. To prevent abuses, the additional first-year depreciation deduction applies only to property purchased in an arm's-length transaction. It does not apply to property received as a gift or from a decedent. In the case of trade-ins, like-kind exchanges, or involuntary conversions, it applies only to any money paid in addition to the traded-in property or in excess of the adjusted basis of the replaced property. It does not apply to property acquired in a nontaxable exchange such as a reorganization, to property acquired from a member of the taxpayer's family, including a spouse, ancestors, and lineal descendants, or from another related entity as defined in Code Sec. 267, nor to property acquired from a person who controls, is controlled by, or is under common control with, the taxpayer. Thus, it does not apply, for example, if one member of an affiliated group of corporations purchases property from another member, or if an individual who controls a corporation purchases property from that corporation. TCJA also removes computer equipment from the category of listed property (as defined in Code Sec. 280F(b)(2)), thus eliminating the depreciation limitation on such property.

TCJA also expands the definition of qualified property eligible for the additional first-year depreciation allowance to include qualified film, television and live theatrical productions, effective for productions placed in service after September 27, 2017, and before January 1, 2023. For this purpose, a production is considered placed in service at the time of initial release, broadcast, or live staged performance (i.e., at the time of the first commercial exhibition, broadcast, or live staged performance of a production to an audience).
TCJA excludes from the definition of qualified property certain public utility property, i.e., property used predominantly in the trade or business of the furnishing or sale of:
(1) electrical energy, water, or sewage disposal services;
(2) gas or steam through a local distribution system; or
(3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a state or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any state or political subdivision thereof.

TCJA also excludes from the definition of qualified property any property used in a trade or business that has had floor plan financing indebtedness, unless the taxpayer which has such trade or business is not a tax shelter prohibited from using the cash method and is exempt from the interest limitation rules by meeting the small business gross receipts test of Code Sec. 448(c).
The provision generally applies to property placed in service after September 27, 2017, in tax years ending after such date, and to specified plants planted or grafted after such date. A transition rule provides that, for a taxpayer's first tax year ending after September 27, 2017, the taxpayer may elect to apply a 50-percent allowance. (return to Business-Related Changes)

Enhanced Expensing Through Section 179 Expense Deductions
TCJA increases the maximum amount a taxpayer may expense under Code Sec. 179 to $1,000,000, and increases the phase-out threshold amount to $2,500,000. Thus, the provision provides that the maximum amount a taxpayer may expense, for tax years beginning after 2017, is $1,000,000 of the cost of qualifying property placed in service for the tax year. The $1,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the tax year exceeds $2,500,000. The $1,000,000 and $2,500,000 amounts, as well as the $25,000 sport utility vehicle limitation, are indexed for inflation for tax years beginning after 2018.
TCJA expands the definition of Code Sec. 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging.
Observation: Property used predominantly to furnish lodging or in connection with furnishing lodging generally includes, for example, beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided.
TCJA also expands the definition of qualified real property eligible for Code Sec. 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems. The provision applies to property placed in service in tax years beginning after December 31, 2017. (return to Business-Related Changes)

Modifications to Depreciation Limitations on Luxury Automobiles and Personal Use Property
TCJA increases the depreciation limitations under Code Sec. 280F that apply to listed property. For passenger automobiles that qualify as luxury automobiles (i.e., gross unloaded weight of 6,000 lbs or more) placed in service after December 31, 2017, and for which the additional first-year depreciation deduction is not claimed, 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 in the recovery period. The limitations are indexed for inflation for luxury passenger automobiles placed in service after 2018.

TCJA removes computer or peripheral equipment from the definition of listed property. Such property is therefore not subject to the heightened substantiation requirements that apply to listed property.
The provision is effective for property placed in service after December 31, 2017. (return to Business-Related Changes)

Modifications of Treatment of Certain Farm Property
TCJA shortens the recovery period from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which begins with the taxpayer and is placed in service after December 31, 2017.
TCJA also repeals the required use of the 150-percent declining balance method for property used in a farming business (i.e., for 3-, 5-, 7-, and 10-year property). The 150-percent declining balance method will continue to apply to any 15-year or 20-year property used in the farming business to which the straight line method does not apply, or to property for which the taxpayer elects the use of the 150-percent declining balance method. The provision is effective for property placed in service after December 31, 2017.

Modification of Net Operating Loss (NOL) Deduction
TCJA limits the NOL deduction to 80 percent of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and may be carried forward indefinitely.

The provision repeals the two-year carryback and the special carryback provisions in current law, but provides a two-year carryback in the case of certain losses incurred in the trade or business of farming. In addition, TCJA provides a two-year carryback and 20-year carryforward for NOLs of a property and casualty insurance company. The provision applies to losses arising in tax years beginning after December 31, 2017. (return to Business-Related Changes)

Modification of Like-Kind Exchange Rules
TCJA modifies the provision providing for nonrecognition of gain in the case of like-kind exchanges by limiting its application to real property that is not held primarily for sale. The 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 such date. (return to Business-Related Changes)

Modification of Alternative Depreciation System Recovery Period for Residential Rental Property
TCJA shortens the alternative depreciation system (ADS) recovery period for residential rental property from 40 to 30 years. It also allows an electing real property trade or business to use the ADS recovery period in depreciating real and qualified improvement property.
Observation: The Senate Bill had shortened the recovery period for determining the depreciation deduction with respect to nonresidential real property from 39 years to 25 years and for residential rental property from 27.5 years to 25 years. Under the Senate Bill, such property placed in service before 2018 would have been treated as having a new placed-in-service date of January 1, 2018, if it resulted in more advantageous deductions. However, this provision was eliminated in TCJA. (return to Business-Related Changes)

Elimination of Separate Definitions Relating to Qualified Leasehold Improvements, Qualified Restaurant, and Qualified Retail Improvement Property
TCJA eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and provides a general 15-year recovery period for qualified improvement property, and a 20-year ADS recovery period for such property. Thus, for example, qualified improvement property placed in service after December 31, 2017, is generally depreciable over 15 years using the straight line method and half-year convention, without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after December 31, 2017, that does not meet the definition of qualified improvement property is depreciable over 39 years as nonresidential real property, using the straight line method and the mid-month convention.

As a conforming amendment, TCJA replaces the references in Code Sec. 179(f) to qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property with a reference to qualified improvement property. TCJA also requires a real property trade or business electing out of the limitation on the deduction for interest to use ADS to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property.
The provision is effective for property placed in service after December 31, 2017. (return to Business-Related Changes)

Modification of Treatment of S Corporation Conversions to C Corporations
TCJA provides that any Code Sec. 481(a) adjustment of an eligible terminated S corporation attributable to the revocation of its S corporation election (i.e., a change from the cash method to an accrual method)

is taken into account ratably during the six-taxable-year period beginning with the year of change. An eligible terminated S corporation is any C corporation which (1) is an S corporation the day before the enactment of TCJA, (2) during the two-year period beginning on the date of such enactment revokes its S corporation election under Code Sec. 1362(a), and (3) all of the owners of which on the date the S corporation election is revoked are the same owners (and in identical proportions) as the owners on the date of such enactment.

Under the provision, in the case of a distribution of money by an eligible terminated S corporation, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of the accumulated adjustments account bears to the amount the accumulated earnings and profits. The provision is effective upon enactment. (return to Business-Related Changes)

Modification of Orphan Drug Credit
TCJA reduces the Orphan Drug Credit rate to 25 percent (instead of current law's 50 percent rate) of qualified clinical testing expenses. The new law also has reporting requirements similar to those required in Code Sec. 48C and Code Sec. 48D. In addition, TCJA strikes any base amount calculation and also the limitation regarding qualified clinical testing expenses to the extent such testing relates to a drug which has previously been approved under Section 505 of the Federal Food, Drug, and Cosmetic Act. The provision applies to amounts paid or incurred in tax years beginning after December 31, 2017. (return to Business-Related Changes)

Small Business Cash Accounting Method Reform and Simplification
TCJA expands the universe of taxpayers that may use the cash method of accounting. Under the provision, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy a gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The gross receipts test allows taxpayers with annual average gross receipts that do not exceed $25 million for the three prior taxable-year period (the "$25 million gross receipts test") to use the cash method. The $25 million amount is indexed for inflation for tax years beginning after 2018.

The provision expands the universe of farming C corporations (and farming partnerships with a C corporation partner) that may use the cash method to include any farming C corporation (or farming partnership with a C corporation partner) that meets the $25 million gross receipts test.

TCJA retains the exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations. Thus, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other passthrough 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 such method clearly reflects income.

The provisions to expand the universe of taxpayers eligible to use the cash method apply to tax years beginning after December 31, 2017. The change to the cash method is a change in the taxpayer's method of accounting for purposes of Code Sec. 481 (return to Business-Related Changes)

Modification of Inventory Classification Rules for Small Businesses
TCJA exempts certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that meet the $25 million gross receipts test are not required to account for inventories under Code Sec. 471, but rather may use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

TCJA expands the exception for small taxpayers from the uniform capitalization rules. Under the provision, any producer or reseller that meets the $25 million gross receipts test is exempted from the application of Code Sec. 263A. The provision retains the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts. Finally, the provision expands the exception for small construction contracts from the requirement to use the percentage-of-completion method. Under the provision, contracts within this exception are those 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.

Under TCJA, a taxpayer who fails the $25 million gross receipts test is not eligible for any of the aforementioned exceptions (i.e., from the accrual method, from keeping inventories, from applying the uniform capitalization rules, or from using the percentage-of completion method) for such tax year.
The provisions to exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules are changes in the taxpayer's method of accounting for purposes of Code Sec. 481. Application of the exception for small construction contracts from the requirement to use the percentage-of-completion method is applied on a cutoff basis for all similarly classified contracts (hence there is no adjustment under Code Sec. 481(a) for contracts entered into before January 1, 2018).

The provisions to expand the universe of taxpayers eligible to use the cash method, exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules apply to tax years beginning after December 31, 2017. The provision to expand the exception for small construction contracts from the requirement to use the percentage-of-completion method applies to contracts entered into after December 31, 2017, in tax years ending after such date.
(return to Business-Related Changes)

Exceptions to Using Uniform Capitalization Rules Expanded
TCJA expands the exception for small taxpayers being subject to the uniform capitalization accounting method rules. Under the provision, any producer or reseller that meets a $25 million gross receipts test is exempted from the application of Code Sec. 263A. In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership. The provision retains the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts.

If a taxpayer changes its method of accounting because it is either no longer required or is required to apply Code Sec. 263A by reason of this provision, such change is treated as initiated by the taxpayer and made with the consent of the Secretary.

The provision apples to tax years beginning after December 31, 2017. Application of these rules would be a change in the taxpayer's method of accounting for purposes of Code Sec. 481. (return to Business-Related Changes)

Increase in Gross Receipts Test for Construction Contract Exception to Percentage of Completion Accounting Method
TCJA expands the exception for small construction contracts from the requirement to use the percentage-of-completion accounting method. Under the provision, contracts within this exception are those 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.
In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership. The provision applies to contracts entered into after December 31, 2017, in tax years ending after such date. Application of this rule would be a change in the taxpayer's method of accounting for purposes of Code Sec. 481, but is applied on a cutoff basis for all

similarly classified contracts (hence there is no adjustment under Code Sec. 481(a) for contracts entered into before January 1, 2018). (return to Business-Related Changes)

Modification of Accounting Method Rules Relating to Income Recognition
TCJA revises the rules associated with the recognition of income. Specifically, the provision requires a taxpayer to recognize income no later than the tax year in which such income is taken into account as income on an applicable financial statement or another financial statement under rules specified by the Secretary, but provides an exception for long-term contract income to which Code Sec. 460 applies.
The provision also codifies the current deferral method of accounting for advance payments for goods and services provided by the IRS under Rev. Proc. 2004-34. That is, the provision allows taxpayers to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.
In addition, the provision directs taxpayers to apply the revenue recognition rules under Code Sec. 451 before applying the OID rules under Code Sec.1272.
Observation: Thus, for example, to the extent amounts are included in income for financial statement purposes when received (e.g., late payment fees, cash-advance fees, or interchange fees), such amounts generally are includable in income at such time in accordance with the general recognition principles under Code Sec. 451.

In the case of any taxpayer required by this provision to change its method of accounting for its first tax year beginning after December 31, 2017, such change is treated as initiated by the taxpayer and made with the consent of the Secretary. The provision applies to tax years beginning after December 31, 2017, and application of these rules would be a change in the taxpayer's method of accounting for purposes of Code Sec. 481. (return to Business-Related Changes)

Changes to Interest Deduction Rules
Under TCJA, in the case of any taxpayer for any tax year, the deduction for business interest is limited to the sum of business interest income plus 30 percent of the adjusted taxable income of the taxpayer for the tax year. There is an exception to this limitation, however, for floor plan financing, which is a specialized type of financing used by car dealerships and certain regulated utilities.

TCJA also exempts from the limitation taxpayers with average annual gross receipts for the three-tax year period ending with the prior tax year that do not exceed $25 million. In addition, for purposes of defining floor plan financing, TCJA modifies the definition of motor vehicle by deleting the specific references to an automobile, a truck, a recreational vehicle, and a motorcycle because those terms are encompassed in the phrase, "any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road."

At the taxpayer's election, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses. The limitation also does not apply to certain regulated public utilities. Specifically, the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof is not treated as a trade or business for purposes of the limitation.

The amount of any interest not allowed as a deduction for any tax year may be carried forward indefinitely. The limitation applies at the taxpayer level. In the case of a group of affiliated corporations that file a consolidated return, it applies at the consolidated tax return filing level. A farming business, including agricultural and horticultural cooperatives, may elect not to be subject to this limitation if the business uses the alternative depreciation system to depreciate any property used in the farming business with a recovery period of 10 years or more. An electing real property trade or business may also elect out of the interest deduction limitation if the business also uses the alternative depreciation system to depreciate its property.

Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for purposes of the Internal Revenue Code is interest for purposes of the provision. Business interest income means the amount of interest includible in the gross income of the taxpayer for the tax year which is properly allocable to a trade or business. Business interest does not include investment interest, and business interest income does not include investment income, within the meaning of Code Sec. 163(d).

By including business interest income in the limitation, the rule operates to limit the deduction for net interest expense to 30 percent of adjusted taxable income. That is, a deduction for business interest is permitted to the full extent of business interest income. To the extent that business interest expense exceeds business interest income, the deduction for the net interest expense is limited to 30 percent of adjusted taxable income.

Generally, adjusted taxable income means the taxable income of the taxpayer computed without regard to:

- any item of income, gain, deduction, or loss which is not properly allocable to a trade or business (but see below for special rules for tax years beginning after 2017 and before 2022);
- any business interest or business interest income;
- the 20 percent deduction for certain pass-through income; an
- the amount of any net operating loss deduction.

However, under TCJA, for tax years beginning after December 31, 2017, and before January 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additionally, because TCJA repeals Code Sec. 199 effective December 31, 2017 (see discussion below), adjusted taxable income is computed without regard to such deduction. TCJA authorizes the IRS to provide other adjustments to the computation of adjusted taxable income.

Application to pass-through entities. In the case of any partnership, the limitation is applied at the partnership level. Any deduction for business interest is taken into account in determining the nonseparately stated taxable income or loss of the partnership. To prevent double counting, special rules are provided for the determination of the adjusted taxable income of each partner of the partnership. Similarly, to allow for additional interest deduction by a partner in the case of an excess amount of unused adjusted taxable income limitation of the partnership, special rules apply. Similar rules apply with respect to any S corporation and its shareholders.

Double counting rule. The adjusted taxable income of each partner (or shareholder, as the case may be) is determined without regard to such partner's distributive share of the nonseparately stated income or loss of such partnership. In the absence of such a rule, the same dollars of adjusted taxable income of a partnership could generate additional interest deductions as the income is passed through to the partners.

Additional deduction limit. The limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess taxable income. The excess taxable income with respect to any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership exceeds the business interest income of the partnership bears to 30 percent of the adjusted taxable income of the partnership. This allows a partner of a partnership to deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. TCJA requires that excess taxable income be allocated in the same manner as nonseparately stated income and loss.

Carryforward of disallowed business interest. The amount of any business interest not allowed as a deduction for any tax year is treated as business interest paid or accrued in the succeeding tax year. Business interest may be carried forward indefinitely. With respect to the limitation on deduction of interest by domestic corporations which are United States shareholders that are members of worldwide affiliated groups with excess domestic indebtedness, whichever rule imposes the lower limitation on the deduction of interest with respect to the tax year (and therefore the greatest amount of interest to be carried forward) governs.

The trade or business of performing services as an employee is not treated as a trade or business for purposes of the limitation. As a result, for example, the wages of an employee are not counted in the adjusted taxable income of the taxpayer for purposes of determining the limitation.
The provision applies to tax years beginning after December 31, 2017. (return to Business-Related Changes)

Repeal of Domestic Activities Production Deduction
Under TCJA, the deduction in Code Sec. 199 for domestic production activities is repealed.
The provision applies to tax years beginning after December 31, 2017. (return to Business-Related Changes)

Limitation on Deduction by Employers of Expenses for Fringe Benefits
TCJA provides that no deduction is allowed 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.
Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such deductions). TCJA also disallows a deduction 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.

Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel). For amounts incurred and paid after December 31, 2017, and until December 31, 2025, the provision expands this 50 percent limitation to expenses of the employer 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, are not deductible.

The provision generally applies to amounts paid or incurred after December 31, 2017. However, for expenses of the employer 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, amounts paid or incurred after December 31, 2025, are not deductible. (return to Business-Related Changes)

Repeal of Deduction for Local Lobbying Expenses
TCJA disallows deductions for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments), effective for amounts paid or incurred on or after December 22, 2017. (return to Business-Related Changes)

Limitation on Deduction Relating to FDIC Premiums
Under TCJA, no deduction is allowed for the applicable percentage of any FDIC premium paid or incurred by certain large financial institutions. For taxpayers with total consolidated assets of $50 billion or more, the applicable percentage is 100 percent. Otherwise, the applicable percentage is the ratio of the excess of total consolidated assets over $10 billion to $40 billion. The provision does not apply to taxpayers with total consolidated assets (as of the close of the tax year) that do not exceed $10 billion. The provision applies to tax years beginning after December 31, 2017. (return to Business-Related Changes)

Contributions to Capital
While TCJA retains Code Sec. 118, a provision the House Bill had sought to repeal, it provides that the term "contributions to capital" does not include -
(1) any contribution in aid of construction or any other contribution as a customer or potential customer, and
(2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).
The Conference Report states that the conferees intended that, as modified, Code Sec. 118, which under current law provides that the gross income of a corporation does not include any contributions to capital, will continue to apply only to corporations.

The provision applies to contributions made after December 22, 2017. However, the provision will not apply to any contribution made after December 22, 2017, by a governmental entity pursuant to a master development plan that has been approved prior to such date by a governmental entity. (return to Business-Related Changes)

Tax Credits
TCJA modifies the rehabilitation credit in Code Sec. 47.
Observation: While both the House Bill and the Senate Bill would have repealed the deduction in Code Sec. 196 for certain unused business credits, the repeal of that provision did not make it into TCJA.
(return to Business-Related Changes)

Change in Determination of Cost Basis of Specified Securities
TCJA does not include a controversial provision in the Senate Bill which would have required that the cost of any specified security sold, exchanged, or otherwise disposed of on or after January 1, 2018, generally be determined on a first-in first-out basis except to the extent the average basis method is otherwise allowed (as in the case of stock of a regulated investment company). The Senate's proposal had included several conforming amendments, including a rule restricting a broker's basis reporting method to the first-in first-out method in the case of the sale of any stock for which the average basis method was not permitted. (return to Business-Related Changes)

Repeal of Rollover of Publicly Traded Securities Gain into Specialized Small Business Investment Companies
TCJA repeals the election that could be made by a corporation or individual to roll over tax-free any capital gain realized on the sale of publicly-traded securities to the extent of the taxpayer's cost of purchasing common stock or a partnership interest in a specialized small business investment company within 60 days of the sale. The amount of gain that an individual could elect to roll over under this provision for a tax year was limited to (1) $50,000 or (2) $500,000 reduced by the gain previously excluded under this provision. For corporations, these limits were $250,000 and $1 million, respectively. The provision applies to sales after December 31, 2017. (return to Business-Related Changes)

Certain Self-Created Property Not Treated as a Capital Asset
TCJA amends Code Sec. 1221(a)(3), resulting in the exclusion of a patent, invention, model or design (whether or not patented), and a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) from the definition of a "capital asset." Thus, gains or

losses from the sale or exchange of a patent, invention, model or design (whether or not patented), or a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) will not receive capital gain treatment. The provision applies to dispositions after December 31, 2017. (return to Business-Related Changes)

Repeal of Technical Termination of Partnerships
TCJA repeals the Code Sec. 708(b)(1)(B) rule providing for technical terminations of partnerships in certain situations. The provision does not change the present-law rule of Code Sec. 708(b)(1)(A) 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. The provision applies to partnership tax years beginning after December 31, 2017(return to Business-Related Changes)

Recharacterization of Certain Gains in the Case of Partnership Profits Interests Held in Connection with Performance of Investment Services
TCJA provides for a three-year holding period in the case of certain net long-term capital gain generated as the result of the receipt of a profits interest in a partnership (sometimes referred to as a carried interest). TCJA clarifies the interaction of Code Sec. 83 with the provision's three-year holding requirement, which applies notwithstanding the rules of Code Sec. 83 or any election in effect under Code Sec. 83(b). Under the provision, the fact that an individual may have included an amount in income upon acquisition of the applicable partnership interest, or that an individual may have made a Code Sec. 83(b) election with respect to an applicable partnership interest, does not change the three-year holding period requirement for long-term capital gain treatment with respect to the applicable partnership interest. Thus, the provision treats as short-term capital gain taxed at ordinary income rates the amount of the taxpayer's net long-term capital gain with respect to an applicable partnership interest for the tax year that exceeds the amount of such gain calculated as if a three-year (not one-year) holding period applies. In making this calculation, the provision takes account of long-term capital losses calculated as if a three-year holding period applies. The provision applies to tax years beginning after December 31, 2017. (return to Business-Related Changes)

Compensation and Benefits
Modification of Limitation on Excessive Employee Remuneration. TCJA revises the definition of covered employee to include both the principal executive officer and the principal financial officer. Further, an individual is a covered employee if the individual holds one of these positions at any time during the tax year. The provision also defines as a covered employee the three (rather than four) most highly compensated officers for the tax year (other than the principal executive officer or principal financial officer) who are required to be reported on the company's proxy statement for the tax year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders). The provision applies to tax years beginning after December 31, 2017. However, there is a transition rule which provides that the proposed changes do not apply to any remuneration under a written binding contract which was in effect on November 2, 2017, and which was not modified after this date in any material respect, and to which the right of the covered employee was no longer subject to a substantial risk of forfeiture on or before December 31, 2016.

Excise Tax on Excess Tax-Exempt Organization Executive Compensation. Under TCJA, an employer is liable for an excise tax equal to 21 percent of the sum of the (1) remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a tax year, and (2) any excess parachute payment (under a new definition for this purpose that relates solely to separation pay) paid by the applicable tax-exempt organization to a covered employee. Accordingly, the excise tax applies as a result of an excess parachute payment, even if the covered employee's remuneration does not exceed $1 million. The provision applies to tax years beginning after December 31, 2017.

Treatment of Qualified Equity Grants. Under TCJA, a qualified employee can 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 (inclusion deferral election) 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. If an employee elects to defer income inclusion under the provision, the income must be included in the employee's income for the tax year that includes the earliest of (1) the first date the qualified stock becomes transferable, including, solely for this purpose, transferable to the employer; (2) the date the employee first becomes an excluded employee (as described below); (3) the first date on which any stock of the employer becomes readily tradable on an established securities market; (4) the date five years after the first date the employee's right to the stock becomes substantially vested; or (5) the date on which the employee revokes her inclusion deferral election. Deferred income inclusion applies also for purposes of the employer's deduction of the amount of income attributable to the qualified stock. The provision generally applies with respect to stock attributable to options exercised or RSUs settled after December 31, 2017.

Excise Tax on Stock Compensation in an Inversion Transaction. TCJA increases the excise tax on stock compensation in an inversion transaction from 15 percent to 20 percent. The provision applies to corporations first becoming expatriated corporations after December 22, 2017. (return to Business-Related Changes)

Partnerships
Tax Gain on the Sale of a Partnership Interest on a Look-through Basis. Under TCJA, gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The provision requires that any gain or loss from the hypothetical asset sale by the partnership be allocated to interests in the partnership in the same manner as nonseparately stated income and loss.

TCJA also requires the transferee of a partnership interest to withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation. If the transferee fails to withhold the correct amount, the partnership is required to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold.

The provision treating gain or loss on sale of a partnership interest as effectively connected income is effective for sales, exchanges, and dispositions on or after November 27, 2017. The portion of the provision requiring withholding on sales or exchanges of partnership interests is effective for sales, exchanges, and dispositions after December 31, 2017.

Modification of the Definition of Substantial Built-in Loss on Transfers of a Partnership Interest. TCJA modifies the definition of a substantial built-in loss for purposes of Code Sec. 743(d), affecting transfers of partnership interests. Under the provision, in addition to the present-law definition, a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.
Example: ABC Partnership has three taxable partners (partners A, B, and C). ABC has not made an election pursuant to Code Sec. 754. The partnership has two assets, one of which, Asset X, has a built-in gain of $1 million, while the other asset, Asset Y, has a built-in loss of $900,000. Pursuant to the ABC partnership agreement, any gain on the sale or exchange of Asset X is specially allocated to partner A. The three partners share equally in all other partnership items, including in the built-in loss in Asset Y. In this case, partner B and partner C each have a net built-in loss of $300,000 (one third of the loss attributable to asset Y) allocable to his partnership interest. Nevertheless, the partnership does not have an overall built-in loss, but a net built-in gain of $100,000 ($1 million minus $900,000). Partner C sells his partnership interest to another person, D, for $33,333. Under the provision, the test for a substantial built-

in loss applies both at the partnership level and at the transferee partner level. If the partnership were to sell all its assets for cash at their fair market value immediately after the transfer to D, D would be allocated a loss of $300,000 (one third of the built-in loss of $900,000 in Asset Y). The partnership does not have a substantial built-in loss, but a substantial built-in loss exists under the partner-level test, and the partnership adjusts the basis of its assets accordingly with respect to D.
The provision applies to transfers of partnership interests after December 31, 2017.

Charitable Contributions and Foreign Taxes Taken into Account in Determining Limitation on Allowance of Partner's Share of Loss. TCJA modifies the basis limitation on partner losses to provide that a partner's distributive share of items that are not deductible in computing the partnership's taxable income, and not properly chargeable to capital account, are allowed only to the extent of the partner's adjusted basis in its partnership interest at the end of the partnership tax year in which the expenditure occurs. Thus, the basis limitation on partner losses applies to a partner's distributive share of charitable contributions and foreign taxes. A partner's distributive share of loss takes into account the partner's distributive share of charitable contributions and foreign taxes for purposes of the basis limitation on partner losses. In the case of a charitable contribution of property whose fair market value exceeds its adjusted basis, the basis limitation on partner losses does not apply to the extent of the partner's distributive share of such excess. The provision applies to partnership tax years beginning after December 31, 2017. (return to Business-Related Changes)

Amortization of Research and Experimental Expenditures
Under TCJA, amounts defined as specified research or experimental expenditures are required to be capitalized and amortized ratably over a five-year period, beginning with the midpoint of the tax year in which the specified research or experimental expenditures were paid or incurred. Specified research or experimental expenditures which are attributable to research that is conducted outside of the United States are required to be capitalized and amortized ratably over a period of 15 years, beginning with the midpoint of the tax year in which such expenditures were paid or incurred. Specified research or experimental expenditures subject to capitalization include expenditures for software development. Specified research or experimental expenditures do not include expenditures for land or for depreciable or depletable property used in connection with the research or experimentation, but do include the depreciation and depletion allowances of such property. Also excluded are exploration expenditures incurred for ore or other minerals (including oil and gas).
This rule will be applied on a cutoff basis to research or experimental expenditures paid or incurred in tax years beginning after December 31, 2025 (hence there is no adjustment under Code Sec. 481(a) for research or experimental expenditures paid or incurred in tax years beginning before January 1, 2026). The provision applies to amounts paid or incurred in tax years beginning after December 31, 2025. (return to Business-Related Changes)

Employer Credit for Paid Family and Medical Leave
For 2018 and 2019, TCJA allows eligible employers to claim a general business credit equal to 12.5 percent of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment under the program is 50 percent of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent.
Observation: An employer must have a written policy in place that provides family and medical leave to all employees on a non-discriminatory basis in order to qualify for the credit. Given the cost of implementing such a policy and complying with yet-to-be-announced reporting requirements, the credit may be impractical for many employers to pursue during the short period it's available. For companies that already have a qualifying family and medical leave plan in place, however, the credit may provide a nice windfall. (return to Business-Related Changes)

Modify Tax Treatment of Alaska Native Corporations and Settlement Trusts
TCJA addresses the tax treatment of Alaska Native Corporations and settlement trusts in three separate but related sections. The first section allows a Native Corporation to assign certain payments described in

the Alaska Native Claims Settlement Act (ANCSA) to a Settlement Trust without having to recognize gross income from those payments, provided the assignment is in writing and the Native Corporation has not received the payment prior to assignment. The Settlement Trust is required to include the assigned payment in gross income when received. The second section allows a Native Corporation to elect annually to deduct contributions made to a Settlement Trust. The third section of the provision requires any Native Corporation which has made an election to deduct contributions to a Settlement Trust as described above to furnish a statement to the Settlement Trust containing: (1) the total amount of contributions; (2) whether such contribution was in cash; (3) for non-cash contributions, the date that such property was acquired by the Native Corporation and the adjusted basis of such property on the contribution date; (4) the date on which each contribution was made to the Settlement Trust; and (5) such information as the Secretary determines is necessary for the accurate reporting of income relating to such contributions.
The provision relating to the exclusion for ANCSA payments assigned to Settlement Trusts is effective to tax years beginning after December 31, 2016. The provision relating to the reporting requirement applies to tax years beginning after December 31, 2016. (return to Business-Related Changes)

Expansion of Qualifying Beneficiaries of an Electing Small Business Trust (ESBT)
TCJA allows a nonresident alien individual to be a potential current beneficiary of an ESBT. The provision takes effect on January 1, 2018. (return to Business-Related Changes)

Charitable Contribution Deduction for ESBTs
TCJA provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock. The provision applies to tax years beginning after December 31, 2017. (return to Business-Related Changes)

Deductibility of Penalties and Fines for Federal Income Tax Purposes
TCJA denies deductibility for any otherwise deductible amount paid or incurred (whether 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 such government or entity into the potential violation of any law. An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance. In the case of any amount of restitution for failure to pay any tax and assessed as restitution under the Code, such restitution is deductible only to the extent it would have been allowed as a deduction if it had been timely paid. Restitution or included remediation of property does not include reimbursement of government investigative or litigation costs.

The provision applies only where a government (or other entity treated in a manner similar to a government under the provision) is a complainant or investigator with respect to the violation or potential violation of any law. An exception also applies to any amount paid or incurred as taxes due.
The provision is effective for amounts paid or incurred after December 22, 2017, except that it does not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception does not apply to an order or agreement requiring court approval unless the approval was obtained before such date. (return to Business-Related Changes)

Aircraft Management Services
TCJA exempts certain payments related to the management of private aircraft from the excise taxes imposed on taxable transportation by air, effective for amounts paid after December 22, 2017. (return to Business-Related Changes)

Qualified Opportunity Zones

TCJA provides for the temporary deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and the permanent exclusion of capital gains from the sale or exchange of an investment in the qualified opportunity fund. The provision allows for the designation of certain low-income community population census tracts as qualified opportunity zones, where low-income communities are defined in Code Sec. 45D(e). The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the tenth calendar year beginning on or after the date of designation. The provision is effective on December 22, 2017. (return to Business-Related Changes)

Expensing of Certain Costs of Replanting Citrus Plants Lost by Reason of Casualty
TCJA modifies the special rule for costs incurred by persons other than the taxpayer in connection with replanting an edible crop for human consumption following loss or damage due to casualty. Under the provision, with respect to replanting costs paid or incurred after December 22, 2017, but no later than a date which is ten years after such date of enactment, for citrus plants lost or damaged due to casualty, such costs may also be deducted by a person other than the taxpayer if (1) the taxpayer has an equity interest of not less than 50 percent in the replanted citrus plants at all times during the tax year in which the replanting costs are paid or incurred and such other person holds any part of the remaining equity interest, or (2) such other person acquires all of the taxpayer's equity interest in the land on which the lost or damaged citrus plants were located at the time of such loss or damage, and the replanting is on such land. (return to Business-Related Changes)

Denial of Deduction for Settlements Subject to a Nondisclosure Agreement Paid in Connection with Sexual Harassment or Sexual Abuse
Under TCJA, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement. The provision is effective for amounts paid or incurred after December 22, 2017. (return to Business-Related Changes)

Repeal of Tax Credit Bonds
TCJA prospectively repeals the authority to issue tax-credit bonds and direct-pay bonds. The provision applies to bonds issued after December 31, 2017. (return to Business-Related Changes)