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PARTNERS BEYOND BOUNDARIES

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This thought leadership compares the conference committee report released on December 15, 2017 with the existing tax provisions and its impact on US corporate taxpayers

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On Friday, December 15, 2017, the House and Senate conferees jointly released a conference report resolving the differences between the bills passed by the House of Representatives and the Senate on November 16, 2017 and December 2, 2017 respectively. *(For our thought leadership covering differences between the House and Senate bill, refer [http://www.knavcpa.com/documents/top-reads/us/Tax%20reform%20article_112117.pdf.](http://www.knavcpa.com/documents/top-reads/us/Tax%20reform%20article_112117.pdf))* The Conference Report is expected to be presented for vote in the US Congress early this week.

This article highlights the key provisions of the conference report impacting corporations.

Topic	Current provision	Conference report provisions	Tax years beginning …	Observation
Domestic Provisions				
Corporate tax rate	• Graduated tax rates with top marginal rate of 35%.	• Single tax rate of 21%. • No special rate for personal service corporations.	2018	• The proposed significant reduction in tax rate will provide a relief to US corporations which are being currently taxed at 34% or 35%.
Alternative Minimum Tax *('AMT')*	• 20% AMT	• Effective on or after December 31, 2017, alternative minimum tax would be repealed. • **The proposal allows the AMT credit to offset the taxpayer's regular tax liability for any taxable year.**	2018	• This provision will provide relief to taxpayers who did not have regular tax liability but were still taxed per the AMT provisions. • The AMT credit can be used to offset regular tax liability and any unused credit thereafter, will be refunded in a phased manner.

		• In addition, the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent *(100 percent in the case of taxable years beginning in 2021)* to an extent that credits exceed regular tax for that year.		
Net operating loss	• Generally, net operating losses can be carried back 2 years and carried forward 20 years without any limitation with regards to taxable income.	• Net operating losses would be allowed to be carried forward indefinitely, but carryback of losses would be eliminated. • NOL deduction would be restricted to 80 percent of taxable income before NOL deduction.	2018	• The utilization of NOLs would be restricted. • At any given point of time, the taxpayer will pay atleast 4% of its taxable income as regular taxes. • Indefinite carryforward period will be helpful for businesses with long turnaround period.
Method of accounting	• Corporations and partnerships *(with corporate partners)* with annual average gross receipts of up to USD 5 million are allowed to use the cash method of accounting.	• Corporations and partnerships *(with corporate partners)* with annual average gross receipts of up to USD 25 million *(indexed for inflation)* would be allowed to use the cash method of accounting.	2018	• The increased threshold will make it easier for small businesses to continue using cash method of accounting and will also be exempted from the complex UNICAP rules.

	• UNICAP rules under IRC section 263A applicable to resellers with annual average gross receipts exceeding USD 10 million. No threshold for manufacturers.	• Also, the UNICAP rules under IRC section 263A would not apply to real and personal property acquired or manufactured by such business.		
Bonus depreciation	• Currently, taxpayers are entitled for 50% bonus depreciation. • Applicable only on new property acquired.	• Taxpayers would be able to immediately deduct 100 percent of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. • Applicable to both new and used property.	2017	• This provision will enable taxpayers to claim bonus depreciation of 100% of the cost of the property for next 5 years. • This deduction is being presented as tax incentive for corporations *(manufacturing sector likely to be the biggest beneficiary)* to undertake capital investments in depreciable assets. • Additionally, applicability of 100% bonus depreciation to used assets for will be beneficial where the assets are acquired in an asset or deemed asset acquisition *(say* 338(h)(10)).
IRC section 179	• Cap of USD 500,000 with phase-out beginning at USD 2 million.	• Cap of USD 1 million with phase-out beginning at USD 2.5 million.	2018	• Under the current rules, the limit for business expensing is USD 500,000 and the phase out amount is USD 2 million. Increasing these limits will enable taxpayers to get an accelerated deduction for capital investments under IRC section 179.
Interest expense	• The disqualified interest is allowed as deduction at 30% of business adjusted taxable income *('EBITDA')*.	• The bill would cap net business interest expense deduction at 30 percent of adjusted business taxable income *(EBITDA till*	2018	• Interest expense allowed as deduction would be further reduced to 30% of adjusted taxable income *(EBITDA upto 2021 and EBIT thereafter)* from the current limit of 50% of EBITDA under IRC section 163(j). • The modification to the definition of adjusted taxable income after 2021 will significantly lower the interest

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	• Disqualified interest means interest paid to foreign related parties and interest towards debt guaranteed by foreign related parties, to the extent not subject to US withholding. • The disallowed interest as per IRC section 163(j) is carried forward indefinitely. • The excess limitation *(i.e. excess of 50% of EBITDA over the net interest expense)* can be carried forward for 3 years and utilized to set off disallowed interest in subsequent years.	*2021 and EBIT thereafter)*. • Business interest, which is not otherwise allowed as a deduction because of IRC section 163(j) can be carried forward indefinitely. • IRC section 381(c) will be amended to include disallowed business interest as a tax attribute thereunder, and conforming amendments will be made under section 382 to treat disallowed business interest as a pre-change loss under subsection (d). • This provision would not apply to a business with average gross receipts of **USD 25 million or less.**		deduction for taxpayers claiming higher depreciation/amortization deduction. • Moreover, unlike the existing section 163(j) provision, the proposed amendment does not include a safe harbor debt-equity ratio. • The proposed IRC section 163(j) limitation applies to, both, related and unrelated party debt as well as to debt held by US and foreign parties. • There is no clarity on how excess limitation will work in the proposed amendment. • Further, disallowed interest carryover shall be treated as a tax attribute subject to limitation under IRC section 382 upon change of control. • Both House and Senate provided for a complex mechanism for calculating additional limitation on a taxpayer who is a member of an international financial reporting group. However, the conference report does not include such additional limitation.
Amortization of Research and Experimental expenditures	• Per the current rules, a taxpayer may either treat research or experimental expenditures as expenses or charge	• Research or experimental expenditures, including software development expenditures, must be capitalized and	2022	• The proposed amendment mandates capitalization of research or experimental expenditures. The option to expense has been eliminated. The period for amortizing foreign research increased to 15 years from the current 5 years.

	it to capital account and amortize it over a period of 60 months.	amortized over a 5-year period *(15 years if expenditures are attributable to foreign research)*. • Land acquisition and improvement costs and mine exploration costs would not be subject to this rule.		
Deductions for Income Attributable to Domestic Production Activities *('DPAD')*	• Currently, a deduction is available for domestic manufacturers to the extent of 9% of lesser of taxable income or qualified production income. The 9% limitation is restricted to 50% of W-2 wages for production activities.	• The bill would repeal the deduction for domestic production activities under IRC section 199, **effective for tax years beginning after 2018** ***(for C Corporations).***	2018	• The deduction benefit available to manufacturers for domestic production activities will no longer be available. The overall impact on effective tax rate due to this could be approximately 1.8% *(9% of taxable income * 20% tax rate)*.
Entertainment and similar expenses	• No restriction on deductibility of expenses pertaining to entertainment, amusement or recreation activities, facilities, or membership dues for employees.	• No deduction will be allowed for entertainment, amusement or recreation activities, facilities, or membership dues. • However, 50% deduction available for employee meals	2018	• The 50-percent limitation under current law would continue to be applicable to expenses incurred for food or beverages and to qualifying business meals, but no deduction would be allowed for other entertainment expenses.

		incurred in connection with business such as eating facility, travel etc. *(until tax year 2025)*		
Like-kind exchanges	• Like-kind exchange provision is applicable to real and personal property.	• The plan would limit the non-recognition of gain in the case of like-kind exchanges to real property that is not held primarily for sale.	2018	• Under the proposed law, like-kind exchange provision would be restricted only to real property.
Business credits	• Various business credits available under the current tax law.	• The bill proposes to either repeal or limit certain business credits that are available under the current law. • Research & Development credit, however, would be preserved.	2018	• Limitations on the various tax credits will affect effective tax rate of many businesses. However, preserving R&D credit will be a big incentive for corporations that invest heavily in R&D activities.
Dividend received deduction *('DRD')*	• The current law provides for DRD of 80% and 70% in case of 20% owned domestic corporation and other domestic corporation respectively.	• The proposal would reduce the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent.	2019	• This reduction is mainly to reflect the lower corporate tax rates which means that dividends would continue to be taxed at 10.5% and 7% respectively.
International provisions				

Dividend received deduction for foreign source dividend and one-time tax on repatriation.	• No such provision as per current law.	• The bill provides 100% deduction for foreign-source portion of dividends received from 'specified 10-percent owned foreign corporations' by US shareholders, subject to a six-month holding period. • Additionally, it proposes tax *(15.5% for liquid assets and 8% for other assets)* on foreign earnings that were still deferred as of the subsidiaries' last tax years ending before 2018. • Taxpayers may elect to pay resulting liability over 8-year period in equal annual installments.	2017	• Dividend received deduction has been expanded to include dividend from foreign corporations. • Additionally, a one-time tax at lower rate has been proposed for accumulated Earnings & Profits. • The proposed reform may encourage multinationals to repatriate undistributed foreign profits to the US.
Underlying foreign tax credit	• Underlying foreign tax credit available in case of dividends received from 10% or more owned foreign entities.	• No foreign tax credit or deduction would be allowed for any taxes paid or accrued with respect to any dividend to which the dividend received deduction under the bill would apply.	2018	• Since foreign-source dividend from specified 10-percent owned foreign corporations is not subject to tax, the underlying foreign tax credit would be repealed.

Limitation on losses with respect to 10-percent-owned foreign corporations	• No such provision under current law.	• A US parent would reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividends received by the US parent from its foreign subsidiary – but only for purpose of determining the amount of loss on any sale or exchange of the foreign subsidiary's stock by its US parent.	2017	• Dividend received will be reduced from the basis only for the purpose of calculating loss on sale of CFC. It will not be reduced in case of a gain.
Base erosion provision – 'Global intangible low-taxed income' *('GILTI')*	• No such provision under current law.	• US corporate shareholders of CFCs would be subject to current US taxation on 50% of "global intangible low-taxed income" (GILTI) with a deduction of 37.5% for foreign-derived intangible income. Basis adjustment rules apply for transfers of intangible property from CFCs to US shareholders.	2017	• This provision is intended to prevent erosion of US tax base by subjecting certain portion of GILTI to tax in the hands of US corporate shareholders on current basis. • Against this inclusion, the bill would permit the US shareholder an indirect foreign tax credit for up to 80% of the CFCs' foreign taxes attributable to shareholder's such income.

Base erosion provision - Base Erosion anti-abuse tax *('BEAT')*	• No such provision under current law.	• An alternative minimum tax is imposed on US corporate taxpayers with annual average gross receipts in excess of USD 500 million on certain deductible payments to foreign related parties to the extent such payments exceed **3 percent** or more of the corporation's deductible expenses *(determined without regard to Sections 172, 245A, and 250)*. • The tax is imposed to the extent that 10 percent of modified taxable income *('MTI')* *(roughly taxable income plus deductible foreign related party payments)* exceeds the corporation's regular tax liability determined after the application of certain credits allowed against the regular tax.	2017	• The BEAT provisions would have an adverse impact on large multinationals, both US - and foreign-parented. • Relief is available for smaller business groups which do not have average annual gross receipts exceeding USD 500 million. • The bill excludes cost of goods sold from the definition of 'deductible payments'. Additionally, deductions with respect to amounts paid or incurred at cost with no markup and that meet the requirements of IRC section 482 for the services cost method *(without regard to the requirement that services do not contribute significantly to fundamental risks of business success or failure)* are excluded.