Tax Cuts and Jobs Act
As Enacted
Effect on Businesses and Business Owners

The ultimately unnamed tax bill (the "Act") was signed into law on December 22, 2017. While several of the more onerous provisions included in the original House Bill (including significant changes to the taxation of nonqualified deferred compensation and a poorly worded provision with respect to taxation of capital contributions to corporations) were eliminated in the Act, there remain a number of provisions that significantly impact the taxation of businesses and their owners.

Below is a brief highlight of the provisions of the Act most directly affecting domestic businesses and their owners. While many of the provisions directly affecting individuals are set to sunset in 2026, the provisions summarized below are permanent, beginning in 2018, unless otherwise noted.

- Corporate Tax Rate: The Act lowers the tax on C-corporations (including personal service corporations) to a flat 21% beginning in 2018. Moreover, the corporate AMT is repealed.

- Change in Treatment of "Pass Through" Businesses: For tax years 2018 through 2025, the Act will change the manner in which much of the income of limited liability companies, partnerships, S-corporations and sole proprietorships is taxed. Owners of those businesses will be taxed at their individual rate less a 20% deduction for "qualified business income."

  - The deduction is not available for pass through investment income such as dividends, capital gains, and investment income.

  - The deduction is capped by an amount equal to the greater of (i) 50% of the employee compensation paid by the business and (ii) the sum of 25% of the employee compensation paid and 2.5% of the business capital investment in depreciating assets.

  - The benefit is not available for most owners of personal services businesses (e.g. doctors, lawyers, accountants, consultants, financial service providers, etc., although engineers and architects do qualify for the benefit), although otherwise excluded service providers with relatively modest taxable income may be able to make use of some or all of this deduction.

  - The deduction is available for non-itemizers and itemizers alike, while it is not taken into account in determining adjusted taxable income.

- **Limitations on Business Interest Expense Deduction:** The Act limits deductions for business interest expense to the sum of business interest income and 30% of the business's adjusted taxable income, with carryforward of any disallowed business interest. For limited liability companies and partnerships, while the computation of what is allowed is performed at the entity level, complicated tracing rules apply at the member and partner level with respect to how disallowed business interest is carried forward and how unused taxable income at the entity level may be utilized by the member or partner to allow deduction of other business interest expense that the member or partner may have paid or incurred during the year.

    - The limitation does not apply to businesses whose average annual gross receipts during the most recent three years does not exceed $25 million.

    - Real property businesses and farming businesses may elect out of this limitation.

    - Regulated utility companies are not subject to the limitation.

    - "Floor plan financing interest" used to finance the acquisition of motor vehicles held for sale or lease which is secured by such acquired inventory is also not subject to the limitation.

- **Limitation on Excess Business Loss:** For taxpayers other than corporations, the Act disallows business losses in excess of $250,000 ($500,000 in the case of a joint return), adjusted for inflation after 2018. Such disallowed excess business loss is thereafter treated as an NOL. This limitation applies after the passive loss limitations are first applied.

- **Accelerated Expensing of Property:** The Act increases from 50% to 100% the first year bonus depreciation deduction of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023 (before January 1, 2024 for certain property with longer production periods). The first year bonus decreases 20% a year for qualified property placed in service after 2022, with the bonus sun-setting after 2026. The Act adds qualified film, television and live theatrical productions to the list of qualified properties.

  The Act also increases the limitations on small businesses expensing Section 179 property from $500,000 to $1 million, with phase-out beginning at $2.5 million instead of $2 million. The new limitations would be indexed for inflation. The definition of Section 179 property is expanded to include depreciable tangible personal property used predominantly in connection with furnishing lodging; as well as improvements to roofs, heating, ventilation, air-conditioning, fire protection and alarm systems, and security systems of nonresidential real property.

Moreover, under the Act, all qualified improvement property placed in service after 2017 can be depreciated on a 15 year, straight line basis, with a 20 year ADS recovery period if that alternative is chosen. For this purpose, qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date the building was first placed in service. For residential rental property, the ADS recovery period is shortened from 40 years to 30 years.

- Net Operating Loss Carrybacks and Carry Forwards: Under the Act, there no longer are any carrybacks of NOLs (except for a two year carryback for farms), but carryforwards will be unlimited. NOLs can only be used to cover at most 80% of a taxpayer's taxable income. NOLs of property and casualty insurance companies are not subject to these changes, and instead are subject to the old rules of 2 year carryback and 20 year carryforward to offset 100% of taxable income in those years.

- Other Changes to Business Related Deductions and Credits: Among the more prominent other relevant changes under the Act are the following:

  - The domestic production activities deduction is repealed.

  - Tax-free like-kind exchanges are limited to exchanges of real property that are not held primarily for sale.

  - The deduction for entertainment expenses is disallowed (although the deduction of 50% of the cost of business meals is retained, with minor expansion of the definition of what constitutes a business meal). Also disallowed is the deduction for transportation fringe benefits expenses (such as parking and mass transit) although the exclusion from income for such benefits received by an employee is retained. In addition, no deduction is allowed for transportation benefits that are the equivalent of commuting for employees, except as provided for the safety of the employee.

  - The deduction for local lobbying expenses has been repealed.

  - The Act permits a general business credit equal to 12.5% of the amount of wages paid to employees while on family and medical leave if the rate of payment is 50% of the wages normally paid. The credit is increased by .25% (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. To qualify for the credit, qualifying full-time employees have to be given at least 2 weeks of annual paid family and medical leave (while part-time employees have to be given such leave on a pro rata basis).

- **Extended Holding Period for Partnership Interests Received for Services:** Under the Act, service providing partners (or related parties) in an investment or real estate business who due to such service are allocated a so-called carried interest in the underlying returns of the business will obtain long term gain treatment on such allocation only to the extent such allocation is attributable to gain realized on assets held for 3 years, instead of the standard 1 year. Such treatment cannot be avoided by selling the partnership interest to a related party in the year of sale.

- **Estate and Generation Skipping Tax:** The Act doubles the estate tax exemption amount to $11.2 million per person for 2018 and thereafter, indexed for inflation, through 2025, with exemption levels returning thereafter to its 2017 level, indexed for inflation. There are no other changes to the gift, estate and generation skipping taxes.

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