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Top Questions About the New Tax Law

The American workforce is stressed out—and finances play a major role. Many workers say they're living paycheck-to-paycheck, and the routine is stressing them out so much that it's taking a toll on their health. Often, people bring their personal financial problems to work, resulting in absences, distractions, or other unproductive behaviors.

The $1.5 trillion tax reform legislation known as the "Tax Cuts and Jobs Act" represents the biggest change to the tax code since 1986. While the implications for both businesses and individuals are broad and complex, we've summarized some of the most commonly asked tax reform questions related to:

- Accounting Methods
- Compensation & Benefits
- Corporate Tax
- Individual Tax
- Income Tax Accounting /ASC 740
- International Tax
- Partnerships/Choice of Entity
- R&D, AMT, Sec. 199
- State and Local Tax

Accounting Methods

How does tax reform impact the deferral of income recognition?

Under the new section 451(b), which takes effect for taxable years beginning after December 31, 2017, an accrual method taxpayer with an applicable financial statement must include an item of income upon the earlier of when the all events test is met or when the taxpayer includes such item in revenue in an applicable financial statement. In other words, income cannot be deferred beyond the taxable year in which such income is taken into account as revenue in an applicable financial statement or another financial statement specified by the Secretary.

How does tax reform impact accrual method vs. cash method of accounting?

Taxpayers that are presently on cash method of accounting may be impacted by method change form procedures and should consult their advisor. While the government has yet to issue the procedural guidance for making method changes under the tax reform bill, we believe it is likely that the guidance will waive certain eligibility rules to allow most taxpayers to file automatic method changes, even if a prior method change was filed in the past five years for the same item.

How does tax reform affect the deferral of advance payments for accrual basis taxpayers?

Prior to the tax reform act, a number of exceptions existed to permit deferral of advance payments. An advance payment is when a taxpayer receives payment before the provision of the goods or services to the customer. The exceptions often allowed tax deferral to mirror financial accounting deferral for a certain time. Effective for tax years beginning after December 31, 2017, section 451(c) codifies the existing one-year deferral method for advance payments for goods, services, and other specified items under Rev. Proc. 2004-34. Accordingly, accrual methods may include the advance payment in the tax year of receipt or elect to defer the inclusion of certain advance payments to the end of the tax year following the tax year of receipt if such income is also deferred for financial statement purposes. The codification of the one-year deferral method for advance payments overrides any deferral method provided by Treas. Reg. section 1.451-5 for advance payments for goods which previously yielded deferral longer than one year. For tax years beginning after December 31, 2017, accrual method taxpayers that are presently deferring advance payments beyond a one-year deferral presumably would need to file a Form 3115, Application for Change in Accounting Method, to request IRS consent to change to conform to the new rule. While the government has yet to issue the procedural guidance for making method changes under the tax reform bill, it is likely that the guidance will provide for automatic changes and waive certain eligibility rules for a limited time.

How does tax reform impact deduction of interest expense?

The tax reform act generally caps the deduction of interest expense to interest income plus 30 percent adjusted taxable income. Real property trades or businesses are allowed to elect out of this limitation. However, taxpayers electing to use the exception to the limitation would be required to use the ADS method for depreciation purposes. As such, the taxpayer would not benefit from bonus depreciation. The legislation does not provide guidance on the treatment of fixed assets placed in service prior to January 1, 2018.

Is bonus depreciation available for qualified improvement property (QIP) placed in service after January 1, 2018?

Pursuant to the tax reform act enacted on December 22, 2017, the definition for QIP was modified in an attempt to simplify the bonus depreciation rules. In the description of the cost recovery provisions for real estate, the last sentence of the explanation of the Conference Agreement (p. 205) stated: "In addition, the conference agreement provides a general 15-year MACRS recovery period for QIP." Accordingly, the intent of Congress is clear. However, due to a drafting error, the legislation removed QIP from the definition of qualified property for bonus depreciation purposes.

The House Ways and Means Committee is expected to address this error in a technical corrections bill. However, it is uncertain when or if that bill will be passed. As such, until further guidance is released, bonus depreciation should not be taken on QIP acquired and placed in service after January 1, 2018.

Compensation and Benefits

What are the deductibility rules for various meal expenses?

- Taking a client to dinner? *50 percent*
- Lunch & learn (internal & external)? *50 percent*
- Working dinner for employees? *50 percent (none after 2025)*
- Traveling employee? *50 percent*
- Office holiday party? *100 percent*
- Meal served in luxury booth at the stadium? *None*

What are the employer and employee tax consequences for transportation benefits?

Employers may no longer deduct the costs of providing parking, transit and shared ride transportation benefits. No changes for employees for continued parking, transit and shared ride transportation benefits – exclusion from the employee's taxable income continues up to monthly dollar amounts ($260 in 2018). However, the monthly bicycling benefit (maximum $20 per month) must be included in the employee's taxable income, thereby securing a compensation deduction for the employer.

Are pay-for-performance plan designs necessary following the repeal of performance-based compensation deductions?

Although the deduction for performance-based compensation was eliminated, publicly-held companies should continue to maintain performance-based compensation in response to the pressure by the investor community (including mutual fund companies, large pension funds, and proxy advisors) to condition pay on corporate performance.

Companies will have more flexibility to design performance-based compensation plans without adhering to the strict rules under section 162(m) (e.g., may increase payout in their discretion, no longer required to prorate the bonus upon a mid-year separation from service).

Review all performance-based compensation arrangements in effect on November 2, 2017, for grandfathered status and avoid modifying these arrangements.

Corporate Tax

What are the top things companies need to know about tax reform?

- A tax deduction up to 20 percent of qualified business income under section 199A for certain owners of pass-through entities.

- Potentially massive tax benefits to company's changing their current choice of entity.
- The corporate AMT and DPAD are gone, but Research Tax Credits live on.
- While NOL carrybacks are gone and there is generally an 80-percent limitation on the use of certain carryforwards, they can now be carried forward indefinitely.
- 100-percent bonus depreciation and expanded expensing will increase asset acquisitions (e.g., as opposed to stock acquisitions or renting) and thus NOLs.

How will the corporate tax rate reduction impact companies and industries?

The corporate tax rate was permanently reduced from 35 percent to 21 percent, beginning in 2018. Unlike most provisions in the new law, including tax breaks for individuals, the new corporate tax rate and certain other corporate tax provisions do not expire. Personal service corporations—like healthcare, law, accounting, consulting, financial services, actuarial sciences, performing arts, and athletics—which have historically been subject to some of the highest tax rates—are now taxed at the same rate as other C corporations, 21 percent.

The corporate AMT, previously set at 20 percent, has also been repealed. And certain corporation's will qualify for the 100-percent dividends received deduction on certain distributions from specified foreign corporations. These corporate rate reducing provisions are designed to increase the competitiveness of corporations globally and domestically.

Individual Tax

Are the individual tax reform changes permanent?

No, in general, the individual tax provisions go into effect on January 1, 2018, but are set to expire on December 31, 2025.

Did the tax rates for individuals change as a result of tax reform?

Yes, starting January 1, 2018, the tax rates for individuals were revised as set forth in the table set forth below. In general, those rates are lower than before. Since the

Tax Rate	Married Filing Jointly and Surviving Spouses	Single	Head of Household	Married Filing Separately	Estates & Trusts
10%	$0 - $19,050	$0 - $9,525	$0 - $13,600	$0 - $9,525	$0 - $2,550
12%	$19,050 - $77,400	$9,525 - $38,700	$13,600 - $51,800	$9,525 - $38,700	N/A
22%	$77,400 - $165,000	$38,700 - $82,500	$51,800 - $82,500	$38,700 - $82,500	N/A
24%	$165,000 - $315,000	$82,500 - $157,500	$82,500 - $157,500	$82,500 - $157,500	$2,550 - $9,150
32%	$315,000 - $400,000	$157,500 - $200,000	$157,500 - $200,000	$157,500 - $200,000	N/A
35%	$400,000 - $600,000	$200,000 - $500,000	$200,000 - $500,000	$200,000 - $300,000	$9,150 - $12,500
37%	Over $600,000	Over $500,000	Over $500,000	Over $300,000	Over $12,500

rates for 2017 are not changed by Tax Reform, the tax rates to apply for 2017 income tax returns, as adjusted by inflation, remain the same. Thus, the Tax Reform changes will be relevant in determining withholdings from wages and estimated tax payments for 2018. The IRS has revised withholding tables for employers to apply to payroll no later than February 15, 2018. Executives/employees should compute their estimated tax liability for 2018 applying the new rates and other changes to the tax law. A review of the rate table reveals that the maximum rate on ordinary income was lowered from 39.6 percent to 37 percent. The maximum rate on long term capital gains and qualified dividend income at 20 percent, remains unchanged.

What happened to standard deductions and personal exemptions under tax reform?

The standard deduction is increased to $24,000 for married filing jointly; $18,000 for head of household and $12,000 for all other taxpayers. These amounts will be indexed for inflation. Personal exemptions are suspended through tax year 2025. With this increase in the standard deduction, many taxpayers will no longer itemize deductions causing a simplification in the preparation of their income tax returns. Because the charitable deduction is an itemized deduction, charities fear that donations may decline since many taxpayers will rely on the standard deduction and will enjoy no tax benefit for a charitable contribution.

Is it true that many of the deductions for individual taxpayers were modified or suspended so that individual taxpayers, in general, will have higher taxable income from 2018-2025?

Yes, especially for taxpayers that itemized deductions in the past, the reduction or elimination of deductions under Tax Reform will result in increased taxable income. Because the tax rates were reduced, each taxpayer will need to apply those reduced tax rates to their increased taxable income to determine if their overall tax liability increases as compared to years prior to 2018. Some of the deductions impacted by Tax Reform include:

- Moving expense deduction is suspended through 2025 except for members of the military moving pursuant to military order.
- Starting in 2019 alimony will no longer be deductible to the payer and will not be income to the recipient. Existing alimony or separation agreements are grandfathered.
- State and local tax deductions will be limited. Taxpayers are permitted a maximum $10,000 deduction on the sum of (i) state and local real property taxes, (ii) state and local personal property taxes and (iii) state and local income taxes (or sales tax, if elected). This new limit will significantly impact the size of federal taxable income post 2017 for those taxpayers living in high tax states, for example, New York and California.
- Interest on a mortgage on a qualified residence will be deductible on acquisition indebtedness of up to $750,000. This is a reduction from prior law of $250,000. Acquisition indebtedness incurred on or prior to December 15, 2017, will be grandfathered up to $1 million. Interest on home equity debt is suspended and is not grandfathered. This change in the deduction of interest expense on a qualified residence will have an impact on the real estate market in those areas with high housing costs. A qualified residence for these purposes includes the principal residence of the taxpayer and one other residence of the taxpayer selected by the taxpayer and used as a residence.
- The deduction of miscellaneous itemized deductions subject to the two percent floor has been suspended. Thus, for example, investment advisory fees, tax return preparation fees and employee business expenses will be non-deductible.
- The deduction of business losses are only permitted in the current year to the extent that they do not exceed the sum of (i) the aggregate gross income attributable to the trade or business plus (ii) $250,000 or $500,000 for a joint return. The excess non-deductible business loss will be added to the taxpayer's net operating loss to be carried forward to future years.
- Net operating losses will no longer be carried back but will be carried forward subject to a deductibility limit of 80 percent of taxable income.

Was alternative minimum tax repealed for individuals?

No, the alternative minimum tax remains for individuals; however, the exemption amount has been increased. With the increased exemption amount and due to the new limit on the deduction of state and local taxes and suspension of the deduction on miscellaneous itemized deductions, fewer individuals will be subject to the alternative minimum tax.

Were any deductions favorably impacted by tax reform?

Yes, the limitation on deduction of cash contributions to public charities was increased from 50 percent of adjusted gross income to 60 percent of adjusted gross income. The floor on the deduction for medical expenses was lowered to 7.5 percent of adjusted gross income for both 2017 and 2018. Medical expenses in excess of the lower floor will be deductible if the taxpayer itemizes deductions.

Income Tax Accounting / ASC 740

What are the timeline impacts of tax reform for ASC 740? How does it impact calendar-year companies?

Tax reform impacts are effective immediately for calendar-year companies. Because the new law was enacted before December 31, 2017, calendar-year companies are required to include the effects of it in their 2017 year-end tax provisions, creating a significant burden on businesses to determine how they're impacted.

Under existing accounting rules, companies are required to account for legislative changes in their Q4 2017 financial statements, recalculating deferred tax assets under the new corporate rate—a process that should be kicked off as soon as possible.

How does tax reform impact ASC 740 fiscal-year companies?

For fiscal year filers, recalculations might be more challenging due to the blended rate application in fiscal 2018 tax years. And while state tax laws are not changing (at least presently), the measurement of state deferred income taxes could be affected by the change in federal tax rate.

Businesses have up to 12 months from the enactment date to complete the accounting for the income tax effects triggered by tax reform. They will need to forecast using "reasonable estimates" and then revise those estimates to reflect additional information, evaluation, and calculation until the accounting is considered complete. Companies also may want to consider accelerating deductions into 2017 or delaying income into future years where it will be taxed at a lower rate.

How can companies ease the burden of all the changes required for ASC 740 under tax reform?

Companies need to reexamine their overall provision, compliance and planning processes and put efficiencies in place to account for impending changes related to ASC 740 and to mitigate risk. Given the additional complexity around financial reporting brought about by tax reform, now is the time to automate. With all of the reform-related changes, automation enables businesses to optimize their business processes and streamline the host of changes to accounting methods and financial reporting, capture newly required and relevant tax data, and decrease the likelihood of calculation errors.

International Tax

How did U.S. tax reform impact the international tax system?

There have been significant changes to the international tax system. In connection with these changes, certain U.S. shareholders who own stock in certain foreign corporations will have to pay a one-time "transition tax" on their share of accumulated overseas earnings. Other changes include a "participation exemption", which is a 100-percent dividend received deduction that permits certain domestic C corporations to receive dividends from their foreign subsidiaries without being taxed on such dividends when certain conditions are satisfied. There is also a new requirement that certain U.S. shareholders of controlled foreign corporations (CFCs) include in income their share of the "global intangible low-taxed income" of such CFCs. Finally, there are new measures to deter base erosion and promote U.S. production.

Is transition tax the same as repatriation tax and section 965?

Yes, both the repatriation tax and section 965 are common ways to refer to transition tax which is a mandatory tax that will be paid by certain U.S. shareholders of certain foreign corporations on their share of earnings accumulated overseas.

What are the timing considerations for the international tax reform impacts?

The transition tax provision may impact tax year 2017. More specifically, the new rules are applicable to the last taxable year of certain foreign corporations beginning before January 1, 2018. Most of the other international changes will impact tax year 2018. Companies should be preparing for 2017 transition tax filings and discussing impacts on foreign-derived intangible income ("FDII"), global intangible low-taxed income ("GILTI"), and Base Erosion and Anti-Abuse Tax ("BEAT") for tax year 2018.

What is the transition tax rate and how do I calculate it?

Of all the international provisions that were enacted, the transition tax may impact tax year 2017 for certain taxpayers. More specifically, the new rules are applicable to the last taxable year of certain foreign corporations beginning before January 1, 2018. Generally speaking, foreign earnings held in the form of cash are taxed at a 15.5 percent rate, and the remaining non-cash earnings will be taxed at an 8 percent rate. These rates may be higher for certain U.S. shareholders. This is a very complex calculation, so consult with International Tax team members who have developed a standardized approach to prepare calculations.

When will we know more detailed rules regarding international tax reform?

The legislation was enacted on December 22, 2017, but we are awaiting further clarification from the IRS on additional details in all areas of the new provisions. The IRS has issued two notices and a revenue procedure to provide guidance with respect to certain aspects of the transition tax calculations. For more, read one of our ITS articles overviewing additional Treasury guidance under 965, changes in section 965 specified foreign corporations' tax years, and an IRS section 965 Q&A. We will keep this section updated as new guidance is released.

Partnerships/Choice of Entity

What are the most important partnership-related tax provisions impacted by tax reform?

Top provisions that impact partnerships are:

- Section 199A qualified business income deduction
- Section 1061 capital gain recharacterization rules
- Repeal of the technical termination rules under section 708(b)(1)(B)
- Application of the section 704(d) basis limitation to charitable contributions and certain foreign taxes
- Modification to the section 743(d) mandatory step-down provisions
- Section 163(j) interest limitation
- Section 461(l) business loss limitation

With the reduced corporate tax rate should partnership entities convert to C corporations?

It's possible that a C corporation conversion may yield a lower overall after-tax cash benefit to the owners. However, there are a number of significant considerations that will impact the choice of entity decision.

Can income from a "specified services" business generate a section 199A deduction?

Yes, the specified services exception is subject to a phase-in based on the taxpayer's total reported taxable income.

If a partnership generates income from a specified services business and a qualifying business, how is the section 199A deduction calculated?

The section 199A deduction and applicable W-2 Wages/Qualified Property limitations are calculated on a business-by-business basis. Guidance is needed in order to determine the extent taxpayer's are able to identify separate trades or business activities.

Are there viable strategies to avoid the section 1061 capital gain recharacterization provisions?

The statute provides that section 1061 does not apply to applicable partnership interests held by corporations. Some advisors are suggesting that this except can be extended to S corporations. This strategy is unlikely to be successful.

It may be possible to amend the partnership operating agreement to allow partners holding applicable partnership interest to forgo allocations of gain from assets held less than three year in favor of gains from assets held more than three years. Care must be taken in creating these modifications to avoid a number of partnership allocation rules under section 704(b).

R&D, AMT, Section 199

How did the TCJA affect the R&D tax credit?

The TCJA increased the R&D tax credit's benefit in several ways, even though it didn't change the R&D tax credit directly.

1. First, the TCJA increased the credit's net IRC section 280C(c) benefit for all taxpayers who report it by about 22 percent because it reduced the maximum corporate tax rate from 35 percent to 21 percent.
2. Second, AMT taxpayers generally weren't allowed to offset their AMT using R&D tax credits. By repealing the AMT, the TCJA exposes former AMT taxpayers to regular income tax, against which they can use R&D tax credits.
3. Third, the TCJA precludes carrying back NOLs generated for tax years beginning after 2017, and allows those NOLs to offset up to only 80 percent of income generated in a given tax year. By thus restricting taxpayers' ability to use NOLs to offset their income tax liability, the TCJA increases the benefit for R&D tax credits because such credits may now be used to help offset that liability.

How did tax reform affect IRC section 199's Domestic Production Activities Deduction (DPAD)?

The TCJA repealed the DPAD for tax years beginning after 2017.

Did tax reform affect any related provisions?

The TCJA reduced the Orphan Drug Credit's rate from 50 percent to 25 percent.

What should companies be doing to plan for these AMT changes?

AMT and NOL taxpayers should ensure they're evaluating whether and by how much R&D tax credits may be used to offset the regular income tax liability to which the TCJA may expose them.

What industries are most impacted by tax reform changes to the R&D tax credit?

Industries with a high percentage of AMT taxpayers should find R&D tax credits more beneficial. Such industries include:

Table 1

Share of AMT and Income Tax by Industry

Industry	Share of Corporate AMT	Share of Total Corporate Income Tax[1]
Agriculture, Forestry, Hunting and Fishing	0%	0%
Mining	16%	2%
Utilities	7%	0%
Construction	1%	1%
Manufacturing	10%	30%
Wholesale and Retail Trade	3%	21%
Transportation and Warehousing	1%	3%
Information	3%	8%
Insurance	35%	9%
Finance, Excluding Insurance	14%	9%
Real Estate and Rental and Leasing	2%	1%
Professional, Scientific, and Technical Services	1%	3%
Management of Companies and Enterprises	5%	9%
Other Service Industries	2%	4%
Total	100%	100%

Source: Internal Revenue Service, Statistics of Income Division, Table 12, 2013.
Note: (1) Total corporate income tax is net of foreign tax credit and other credits.

State and Local Tax

Do states have to do anything to conform to federal tax reform?

In general, states conform to changes in the Internal Revenue Code on a "rolling" (as amended) basis or on a "fixed-date" (in effect on, enacted on) basis. The "fixed-date" conformity states will have to enact their own legislation to conform. The "rolling" conformity states will automatically conform, unless they enact legislation to decouple from specific provisions of federal tax reform.

What are the most likely aspects of federal tax reform that will have SALT impact?

The three most likely to impact state taxes or raise questions will probably arise under (1) state tax treatment of the Deemed Repatriation Transition Tax (DRTT) and the global intangible low-taxed income tax, (2) the new business interest limitation, and (3) the QBI deduction for pass-through entities.

Also, while most states already decouple from federal bonus depreciation, some may have to amend their statues, as we anticipate few states will conform to full-expensing.

What is the state issue with the QBI deduction?

Quite simply, most states begin the calculation of state taxable income for personal income tax purposes with federal AGI and the QBI deduction will not enter into AGI; rather, it is a deduction from federal taxable income.

Will states follow the federal election to pay the DRTT in annual installments?

States will likely have to enact their own legislation allowing this election, if the DRTT results in a state tax liability.

What about for S corporation shareholders and the "triggering event" election?

Likewise, states will have to enact their own legislation to allow this election.

Do you anticipate state legislation in response to federal tax reform?

We anticipate very active 2018 state legislative sessions, perhaps the busiest in history in terms of state tax legislation. About half of the states went into legislative session in January, while the others will commence their legislative sessions in February and March. A few states (e.g., Texas) follow a biennial legislative agenda and their legislatures won't meet again until 2019.