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In this issue:

Corporate and general business tax provisions

In general, the Act contains similar corporate tax provisions to the earlier versions approved in the House and Senate, and therefore does not significantly modify the current corporate tax system, which generally imposes tax on corporate income at both the entity level and the shareholder level. There will still be softening of this double-tax system due to rate reduction, however, and more fundamental changes in the cross-border context (discussed elsewhere in this publication), but without an adoption of a direct corporate integration measure. Furthermore, similar to the prior bills, transactions with respect to stock of a corporation will generally be treated the same as under current law, and the enacted legislation does not propose changes to the consolidated return provisions.

Corporate rate reduction

The Act reduces the general corporate tax rate to 21 percent for tax years beginning after December 31, 2017. It eliminates the prior brackets and the special tax rate for personal service corporations. As in the House bill (but not the Senate version), the corporate alternative minimum tax also is eliminated, with an expanded utilization of existing AMT credits against regular tax liability for tax years beginning after 2017 and before 2022, with credits also refundable in an amount equal to 50 percent (100 percent for tax years beginning in 2021) of the excess of the AMT credit for the tax year less the amount of the credit allowable against regular tax liability for that year. The Act adopts the same approach to fiscal year taxpayers as did the Senate version: Section 15 explicitly does not apply to the temporary individual rate changes under new section 1(j) and, thus, it appears that the provision will apply to the corporate rate reduction. Under section 15, a fiscal year taxpayer may obtain the benefit of the reduced corporate rate as of January 1, 2018, generally by computing a tentative tax under both rates, and then prorating the tentative tax based on number of days with and without the rate change to arrive at a "blended" tax rate.

Dividends received deduction

The Act reduces the dividends received deduction (the DRD, in general, applicable to corporate shareholders receiving a dividend from certain domestic corporations) for the 70 percent and 80 percent brackets, to 50 percent and 65 percent, respectively. The 100 percent DRD remains intact for dividends from affiliated group members. This appears to be the identical provision as in the House and Senate bills, and would generally retain the effective tax rate on such distributions at the corporate shareholder level after reducing the corporate tax rate. The DRD provision is effective for tax years beginning after December 31, 2017. There are also DRD provisions related to the international tax provisions in the Act (discussed elsewhere in this publication).

Modification of the net operating loss deduction

As in prior bills, the Act modifies aspects of prior law regarding net operating losses (NOLs). Under prior law, NOLs generally had a carryback period of two years and a carryforward period of 20 years. The Act, like earlier versions of the legislation, generally eliminates the NOL carryback period and makes the carryforward period indefinite. The amount of the NOL deduction allowed is limited to 80 percent of taxable income computed without regard to the NOL deduction, however, rather than 90 percent, as in the House version and the introductory period in the Senate version. Special rules apply to certain farming and insurance losses.

The enacted legislation does not increase the amount of NOLs by an annual interest factor, as proposed in the House bill (but not the Senate version).

Conforming amendments include, but are not limited to: (1) the repeal of carrybacks of specified liability losses defined in section 172(f) and (2) excess interest losses related to corporate equity reduction transactions under section 172(g) (the so-called CERT rules).

In general, the effective date is December 31, 2017, with the amendments to carryback and carryforward periods applying to NOLs arising in tax years ending after December 31, 2017, and with the limitation on NOL utilization (tied to 80 percent of taxable income) applying to losses arising in tax years beginning after December 31, 2017. The effective date provisions are consistent with the Senate bill but not the House version.

Limitation on business interest

Under prior law, section 163(j) limited the ability of certain corporations to deduct interest paid or accrued on indebtedness. In general, this limit applied to interest paid or accrued by certain corporations (where no US federal income tax is imposed on the interest income) whose debt-to-equity ratio exceeds 1.5 to 1.0, and where net interest expense exceeds 50 percent of its adjusted taxable income.

The Act expands the interest deductibility limitation under section 163(j) consistent with the prior bills but with certain adjustments. The general rule remains the same as compared to prior bills; the new provision generally limits the interest deduction on business interest to (1) business interest income, plus (2) 30 percent of the taxpayer's adjusted taxable income. Business interest and business interest income is defined as that allocable to a trade or business and not investment interest and income, within the meaning of section 163(d). Adjusted taxable income is computed without regard to any (1) item of income, gain, deduction, or loss, which is not allocable to the trade or business; (2) business interest income or expense; (3) any deduction allowed under section 199A (i.e., the 20 percent deduction for certain pass-through income, as described elsewhere in this publication); (4) the NOL deduction; and (5) depreciation, amortization, or depletion for tax years beginning before January 1, 2022, but taking into account depreciation, amortization, and depletion thereafter.

The limitation described above generally applies at the taxpayer level. There are special rules that apply to partnerships (more on that below). In the case of a group of affiliated corporations that file a consolidated return, the report that accompanied the conference committee agreement for the new law clarifies that the limitation applies at the consolidated tax return filing level.

For partnerships, the limitation is applied at the partnership level, with business interest expense taken in account in determining the partnership's non-separately stated taxable income or loss. A partner may also be subject to the new interest deduction limitation with respect to the partner's own business interest expense. If so, the adjusted taxable income of the partner will not include the partner's distributive share of all items of income, gain, deduction, or loss of the partnership. This avoids double counting of adjusted taxable income to allow for interest deductibility twice for the same taxable income. The partnership, however, may have excess taxable income. This excess taxable income may be taken into account by the partner in computing the partner's limitation. This allows the partner to deduct more business interest if the partnership could have deducted more business interest.

This provision generally applies to all taxpayers. It provides an exception for certain small businesses whose average annual gross receipts for the three- taxable-year period ending with the prior tax year do not exceed $25 million, and for interest allocable to performing services as an employee and businesses of certain regulated public utilities. The Act follows the Senate bill, which allows, at the taxpayer's election, a taxpayer not to apply the limitation to certain real property-related trades or businesses and certain farming businesses. There is a narrow exception for so-called "floor plan financing indebtedness" that, in general, would apply to certain financing of acquisitions for the sale or lease of certain motor vehicles.

Under the Act, business interest that is not otherwise allowed as a deduction by reason of 163(j) is treated as paid or accrued in the succeeding tax year, and may be carried forward indefinitely. Similar to prior bills, section 381(c) is

amended to include disallowed business interest as a tax attribute thereunder, and section 382 is amended to treat disallowed business interest as a pre-change loss under subsection (d).

The enacted legislation removes the separate interest deduction limitation provision under section 163(n) that would have applied to certain domestic corporations that are members of worldwide affiliated groups under the prior bills (discussed elsewhere in this publication). Under those bills, taxpayers would only obtain the lesser of interest deductions allowed under new sections 163(j) and (n).

The modifications described above apply to tax years beginning after December 31, 2017.

Cost basis of specified securities

The Act did not adopt the Senate proposal to require the "first-in first-out" method for identifying specified securities sold at different dates except if otherwise allowed. Under current law, a taxpayer generally must apply a first-in first-out approach in identifying stock in a corporation acquired at different dates or at different prices, when selling or transferring some of the shares of that stock. If a taxpayer makes an adequate identification of shares of stock sold (referred to as specific identification), however, such a determination would control. Special rules apply to shares of stock in regulated investment companies (RICs) that generally permit an averaging approach. The enacted legislation does not affect current law.

Contributions to capital

The Act modifies the treatment of contributions to capital, but narrowly and not as broadly as proposed in the House-approved measure. It provides that the term contribution to capital does not include (1) contributions in aid of construction or any other contribution as a customer or potential customer, and (2) any nonshareholder contribution by any governmental entity or civic group. Thus, its application is focused on nonshareholder contributions and leaves untouched tax-free treatment for other capital contributions at the corporate transferee level, including the treatment of debt contributed to the capital of a corporate debtor. The House bill would have applied more broadly by its flush language, including revoking section 108(e)(6).

Alternative minimum tax

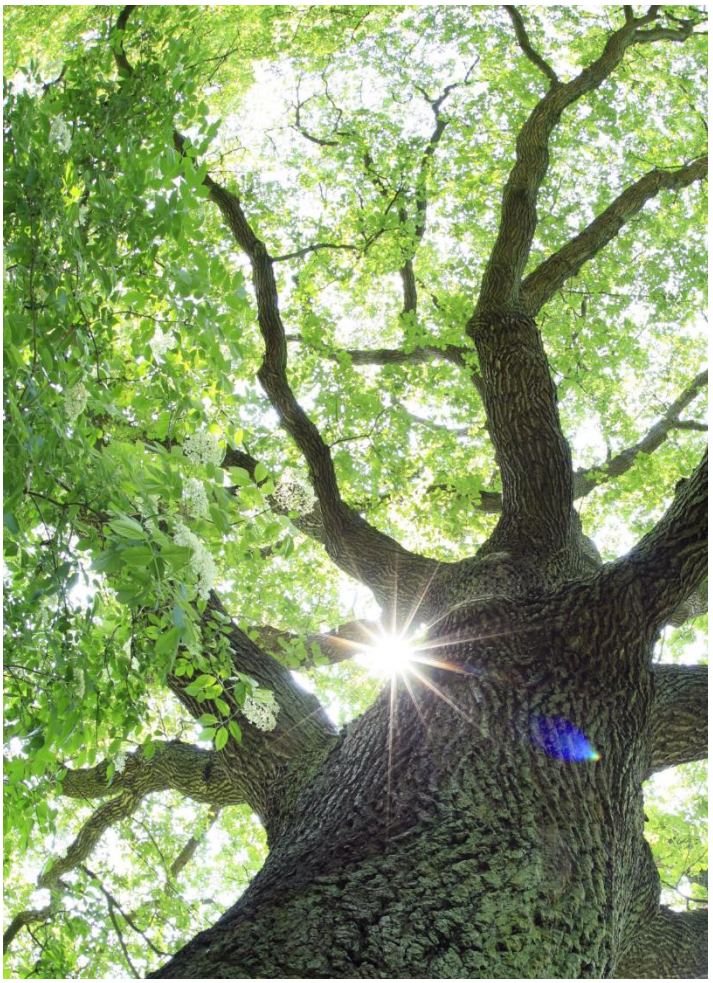
The Act repeals the corporate alternative minimum tax for tax years beginning after December 31, 2017. Taxpayers may claim a refund on any AMT credit carryovers—50 percent of remaining AMT credits in tax years 2018, 2019, and 2020, and a refund on all remaining credits in the tax year 2021.

Full expensing of qualified property

The Act modifies section 168 bonus depreciation to allow for full expensing of qualified property placed into service after September 27, 2017, and before January 1, 2023. Thereafter, the bonus depreciation percentage phases down annually through 2026 (80 percent in 2023, 60 percent in 2024, 40 percent in 2025, and 20 percent in 2026). Property with longer production periods and certain aircraft receive an additional year of full expensing, with phasedowns also beginning a year later. The full expensing provision also eliminates the requirement that the original use of the property begins with the taxpayer. Thus, property qualifies under this provision as long as the property was not used by the taxpayer prior to the time of acquisition.

The Act makes no changes to section 168(k)(7), which permits a taxpayer to elect out of bonus depreciation on an asset-class-by-asset-class basis.

Deductions, exclusions, income recognition



Revenue recognition: The Act requires taxpayers to recognize income no later than the taxable year in which such income is taken into account as income on the taxpayer's applicable financial statement. However, this requirement does not apply with respect to any special methods of accounting other than for certain rules involving bonds and debt instruments. The Act also codifies the deferral method of accounting for advanced payments for goods and services currently provided under Rev. Proc. 2004-34. These provisions are effective for taxable years beginning after December 31, 2017.

Like-kind exchanges of real property: The Act limits the scope of like-kind exchange nonrecognition treatment to real property not held primarily for sale. Thus, personal property that previously qualified for nonrecognition treatment no longer qualifies under the Act. The provision does not apply to any exchange where the property disposed of or received in the exchange by the taxpayer was disposed of or received before December 31, 2017.

Local lobbying expenses: The Act repeals the deduction for local lobbying expenses, which includes lobbying before Indian tribal governments. Therefore, amounts paid or incurred after the date of enactment will not be deductible. This change conforms the treatment of local lobbying expenses to that of other lobbying and political expenses, which have been and continue to be nondeductible.

Section 199 deduction: The Act repeals the section 199 deduction, effective for tax years after December 31, 2017.

Treatment of self-created property: The Act excludes patents, inventions, models or designs, and secret formulas or processes as qualifying as a capital asset under section 1221. Under prior law, these items were treated as capital assets. Under the Act, the gain or loss from the sale of a self-created patent, invention, model or design, or secret formula or process will not receive capital gain treatment. This provision is effective for disposition of such property after 2017.

Recovery period of real property: The Act eliminates the separate definitions of qualified leasehold improvements, qualified restaurants, and qualified retail improvement property, and instead provides for a single asset class called "qualified improvement property" (QIP). According to the conference report for the Act, QIP is intended to have a 15-year regular MACRS recovery period and 20-year ADS recovery period. These provisions apply to property placed in service after December 31, 2017. The Act makes no changes to the MACRS recovery period for nonresidential real and residential rental property.

Section 179 expensing: The Act increases the section 179 expense election threshold to $1 million. The phaseout of this expense election begins when the cost of qualifying property placed in service reaches $2.5 million. The Act also expands the definition of section 179 property to include certain property used in furnishing lodging, and roofs, heating, ventilation, air-conditioning property, fire protection and alarm systems, and security systems for nonresidential real property that are placed in service after December 31, 2017.

Accounting methods for small taxpayers: The Act expands the scope of eligible taxpayers who may use the cash method of accounting. It allows taxpayers with annual average gross receipts of $25 million or less to use the cash method. This gross receipt limit also applies to farming C corporations.

The Act also generally exempts taxpayers that meet the $25 million gross receipts test from the requirement to keep inventories. Rather, these qualifying taxpayers either can treat inventories as nonincidental materials and supplies or move to a method that conforms to its applicable financial statement method. Taxpayers qualifying under the $25 million gross receipts test are also excluded from the uniform capitalization rules of section 263A.

The Act also expands the exception for small construction contracts from using the percentage-of-completion method under section 460 for contracts that are expected to be completed within two years of commencement of the contract, and that are performed by a taxpayer that meets the $25 million gross receipts test.

Research and experimental expenditures: Beginning in 2022, the Act requires research and experimental expenditures to be capitalized and amortized ratably over a five-year period. Any such expenditures attributable to research conducted outside the United States must be capitalized and amortized over a 15-year period. These rules do not apply to expenditures for the acquisition or improvement of land, or for expenditures paid to ascertain the existence, location, extent, or quality of mineral deposits, including oil and gas. Software development expenditures shall be treated as research or experimental expenditures.

Fines and penalties: The Act denies a deduction for any amounts paid or incurred to, or at the direction of, a government or governmental entity in relation to the violation of any law or investigation into the potential violation of any law. This provision thus increases the scope of nondeductible fines and penalties under section 162(f). Restitution payments are, however, excluded from this limitation, and can be deducted. The Act also adds the reporting requirement that an appropriate official of the government or governmental entity provide the IRS and each party to the settlement information detailing the amount and nature of any payments and agreement. The provision applies to any amounts paid or incurred on or after the date of enactment.

Credit for paid family and medical leave: Act creates a new employer credit for paid family and medical leave in section 45S that permits eligible employers (employers that allow all qualifying full-time employees at least two weeks of annual paid family and medical leave and allow part-time employees a commensurate amount of leave on a pro rata basis) to claim a business credit for 12.5 percent of the wages paid to qualifying employees during any period in which such employees are on family and medical leave if the payment rate 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.

The credit is effective for wages paid in tax years beginning after December 31, 2017, but does not apply to wages paid in tax years beginning after December 31, 2019.

Other general business credits: Notably, the Act generally retains other general business credits, including the research credit, low-income housing tax credit, new markets tax credit, work opportunity tax credit, FICA tip credit, employer provided childcare credit, access to disabled individuals credit, production tax credit, energy investment tax credit, plug-in electric vehicle credit, enhanced oil recovery credit, marginal well credit, and nuclear production tax credit. Further, it leaves in place the deduction for certain unused business credits under section 196.

Base Erosion and Anti-Abuse Tax: It is noteworthy that certain multinational companies claiming any general business credits could be impacted by the Base Erosion and Anti-Abuse Tax (BEAT) in section 59A. The Act creates the BEAT, which provides a base erosion minimum tax of 5 percent in 2018, 10 percent in 2019 through 2025 (11 percent for banks and securities dealers), and 12.5 percent after 2025 (13.5 for banks and securities dealers). The Act provides that certain general business credits may be claimed against BEAT liability through 2025 (research credits and 80 percent of low- income housing tax credits, investment tax credits, and production tax credits).

The BEAT provision may have a significant impact on the ability of major financial institutions to participate in the tax equity financing marketplace. The BEAT would be applicable to credits generated as a result of projects that began operating in prior years. (See additional discussion on the BEAT in the international tax section of this publication.)

International tax issues

Transition to territoriality

Dividends received deduction: The Act provides for a 100 percent dividends received deduction for the foreign-source portion of dividends received from specified 10-percent-owned foreign corporations by domestic corporations that are US shareholders. For this purpose, an amount received by a domestic corporation that is treated as a dividend under section 1248 is treated as a dividend for purposes of the DRD (provided the holding period requirements are satisfied). In addition, if the gain is recognized by a lower tier CFC and characterized as a dividend under section 964(e), then such amount is included in subpart F income for the year of the sale but the US shareholder can claim a DRD with respect to such amount.

No foreign tax credit or deduction is allowed for taxes paid or accrued with respect to such dividend that qualifies for the DRD.

In addition, consistent with the Senate legislation, the bill provides: (1) a limitation on the DRD for any dividend received if the foreign corporation receives a deduction (or other tax benefit) from taxes imposed by a foreign country (hybrid dividend) and (2) an expanded holding period requirement.

Finally, the conference committee explanation provides that any hybrid dividend received by a CFC is treated as subpart F income for the taxable year such dividend was received.

Limitation on losses with respect to 10-percent-owned foreign corporations: The basis in foreign corporations with respect to which the dividends received deduction applies is reduced by the amount of any such dividend, but only for purposes of computing loss on the sale or exchange of that stock.

Taxation of deferred foreign income upon transition: Consistent with the House bill and the Senate bill, a US shareholder of a foreign corporation must include in income for the subsidiary's last tax year beginning before January 1, 2018, the shareholder's pro rata share of undistributed and previously untaxed post-1986 foreign earnings. Earnings and profits (E&P) is only taken into account to the extent it was accumulated during periods when the foreign corporation was a CFC or was a non-CFC foreign corporation that had at least one domestic corporation as its US shareholder.

The amount of such E&P is the greater of the amounts determined as of November 2, 2017, or December 31, 2017, unreduced by dividends (other than dividends to other specified foreign corporations) during the taxable year to which the provision applies.

The mandatory inclusion generally may be reduced by foreign earnings and profits deficits (including hovering deficits) that are properly allocable to that person. In addition, unlike the Senate bill, the mandatory inclusion may be reduced by the pro rata share of deficits of another US shareholder that is a member of the same affiliated group.

For purposes of this provision, the E&P is classified as either E&P that has been retained in the form of cash or cash equivalents, or E&P that has been reinvested in the foreign subsidiary's business (for example, property, plant, and equipment). The portion of the E&P comprising cash or cash equivalents is taxed at a reduced rate of 15.5 percent, while any remaining E&P is taxed at a reduced rate of 8 percent.

Rules will be provided to avoid the double counting of cash assets. In addition, the Act grants regulatory authority to the Treasury to issue regulations to prevent the avoidance of the rules, including through a reduction of earnings and profits, through changes in entity classification, or accounting methods, or otherwise.

Limitation on assessment extended: Consistent with the Senate bill, the Act extends the assessment statute of limitations for taxpayers reporting a mandatory inclusion. The assessment statute of limitations is generally extended to six years from the date upon which the return was filed that initially reflects the mandatory inclusion.

Special rules for expatriated entities: Consistent with the Senate bill, the enacted legislation increases the rate of tax imposed on the deferred earnings of a specified foreign corporation if within 10 years of the date of enactment, the US shareholder of such corporation engages in an "inversion transaction" subject to section 7874.

Others provisions: In addition, the legislation provides: (1) that foreign tax credit carryforwards are fully available, and foreign tax credits triggered by the deemed repatriation are partially available, to offset the US tax; (2) that at the election of the US shareholder, the tax liability would be payable over a period of up to eight years; (3) special rules which would apply with respect to S corporations and their shareholders, as well as REITs; and (4) an election not to apply any net operating loss deduction against the amount taken into account under the transition tax rules.

Rules related to passive and mobile income

Global intangible low-taxed income: The enacted legislation largely adopts, with modifications, provisions in the Senate bill designed to tax currently global intangible low-taxed income (GILTI). Under the provision, a US shareholder is required to include in gross income the amount of its GILTI. However, the US shareholder is allowed a deduction equal to 50 percent of the GILTI and the amount treated as a dividend by reason of the US shareholder claiming a foreign tax credit as a result of the inclusion of the GILTI amount in income ("section 78 gross up").

GILTI is the excess of the shareholder's net tested income over the deemed tangible income return, which is defined as the excess of 10 percent of the shareholder's basis in tangible property used to produce tested income less the amount of interest expense allocated to net tested income. The reduction of this amount by allocated interest expense is a change from the original Senate bill and more closely follows an approach adopted by the House Ways and Means Committee with respect to their proposal.

Tested income for this purpose is the gross income of the corporation determined without regard to the following exceptions: (1) the corporation's effectively connected income under section 952(b); (2) any gross income taken into account in determining the corporation's subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income and foreign oil related income, over deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5).

Consistent with the Senate bill, the amount of GILTI included by a US shareholder is allocated across all of such shareholder's CFCs, based on each CFC's proportionate share of tested income. In addition, the shareholder can claim a foreign tax credit for 80 percent of the taxes paid or accrued with respect to the tested income of each CFC from which the shareholder has an inclusion.

Deduction for foreign-derived intangible income: In addition to the immediate inclusion of GILTI, the Act allows a domestic corporation a deduction for 37.5 percent of the foreign-derived intangible income and a 50 percent deduction of the GILTI plus the section 78 gross up, as discussed above. These deductions are reduced to 21.875 percent and 37.5 percent, respectively, in taxable years beginning after December 31, 2025.

Foreign-derived intangible income is an amount equal to the corporation's deemed intangible income multiplied by an amount equal to the corporation's foreign-derived, deduction-eligible income over its total deduction-eligible income.

Deduction-eligible income is the gross income of the corporation determined without regard to: (1) the subpart F income of the corporation under section 951; (2) the GILTI of the corporation; (3) financial services income; (4) any dividend received from a CFC with respect to which the corporation is a US shareholder; (5) any domestic oil and gas income of the corporation; and (6) any foreign branch income (as defined in section 904(d)(2)(J)) of the corporation, over the deductions (including taxes) properly allocable to such gross income.

Deemed intangible income is the excess of a corporation's deduction-eligible income over 10 percent of the basis in its tangible depreciable property used to produce deduction-eligible income.

Foreign-derived, deduction-eligible income means with respect to a taxpayer for its taxable year, any deduction-eligible income of the taxpayer that is derived in connection with (1) property that is sold by the taxpayer to any person who is not a US person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States. For this purpose, the terms sold, sells, and sale include any lease, license, exchange, or other disposition of property.

Treatment of hybrid transactions

The Act includes the provision from the Senate bill that would deny the deduction for any disqualified related- party amount paid pursuant to a hybrid transaction or by or to a hybrid payment. A disqualified related-party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country.

A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax.

A hybrid entity is any entity which is either: (1) treated as fiscally transparent for federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for federal income tax purposes.

Base erosion proposals

The Act adopts the Senate bill's provisions related to base eroding payments, with certain modifications. Accordingly, a corporation (other than a RIC, REIT or S corporation) with excess base erosion payments for the taxable year must pay a tax equal to the excess of 10 percent (5 percent for taxable years beginning in 2018) of its taxable income (determined without regard to deductions attributable to base erosion payments) over its regular tax liability reduced by the excess of credits allowed under Chapter 1 against the regular tax liability over the sum of the R&D credit plus 80 percent of the sum of the low-income housing credit, the renewable electricity production credit determined under section 45(a), and the energy property investment credit determined under section 48.

For purposes of this provision, a base erosion payment generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation). A base erosion payment also includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid to or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, but only if such person became a surrogate foreign corporation after November 9, 2017, and (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2).

A base erosion payment does not include: (1) any amount paid or accrued for services if such services meet the requirements for eligibility of the services cost method in Treas. Reg. sec. 1.482-9, without regard to certain requirements of that section and provided the payments are made without a mark-up, and (2) a "qualified derivative payment." In addition, a corporation is not subject to the provision if it has average annual gross receipts for the three-taxable-year period ending with the preceding taxable year of less than $500 million or its base erosion percentage is less than 3 percent. (The term base erosion percentage means for any taxable year, the percentage determined by dividing the aggregate amount of deductions attributable to base eroding payments by the total amount of all deductions allowable to the taxpayer during the taxable year, without regard to deductions under sections 172, 245A or 250, any deduction for services which are not treated as base eroding payments, and any deduction for qualified derivative payments. In the case of a bank or registered securities dealer, the 3 percent base erosion percentage threshold is lowered to 2 percent.)

Information reporting requirement: The Act provides for increased information reporting under sections 6038A and 6038C to require certain taxpayers subject to the new base erosion provisions to report information such as base erosion payments, information for determining the base erosion minimum tax, and other information deemed necessary by the Secretary of the Treasury. In addition, it increases the penalty from $10,000 to $25,000 for failure to comply with section 6038A and increases the penalty for failure to comply within 90 days after IRS notification to $25,000 for each 30-day period thereafter.

Interest expense limitation

Section 163(j): The general limitation on interest deductibility contained in section 163(j) is modified and generally follows the proposal included in the Senate bill. Details on this provision are included in the discussion of corporate tax issues elsewhere in this report.

Section 163(n): The provisions that were originally included in both the House and Senate bills addressing interest expense incurred by domestic corporations that are members of an international group were not included in the enacted legislation.

Other international provisions

Codification of Rev Rul. 91-32: The bill adopts the Senate proposal with respect to Rev. Rul. 91-32. Accordingly, gain or loss from the sale or exchange of a partnership interest is effectively connected with a US 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 Act requires that any gain or loss from the hypothetical asset sale by the partnership be allocated. In addition, the transferee of a partnership interest is required 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.

Although the provision applies to sales or exchanges on or after November 27, 2017, the portion imposing the withholding tax obligation applies to sales or exchanges occurring after December 31, 2017. The Treasury Department and IRS, however, announced in Notice 2018-08 (released December 29, 2017) that withholding is suspended pending the issuance of further guidance.

In addition, the Act includes provisions to:

- Modify the definition of a US shareholder to include any US person who owns 10 percent or more of the total value of the foreign corporation (as opposed to vote);
- Modify the definition of section 936(h)(3)(B) to include workforce in place, goodwill, and going concern value;
- Impose a limitation on claiming lower rates on dividends from certain corporations subject to section 7874;
- Impose a separate foreign tax credit limitation category for branch income;
- Repeal the fair market value method for allocating interest expense;
- Eliminate foreign base company oil-related income as a category of subpart F income;
- Provide for an inflation adjustment to the de minimis rule;
- Repeal subpart F inclusions based on the withdrawal of previously excluded subpart F income invested in foreign base company shipping operations;

- Eliminate the limitation on attribution of stock from a foreign person to a US shareholder;
- Eliminate the requirement that a foreign corporation must be a CFC for an uninterrupted period of 30 days for subpart F to apply;
- Repeal the section 902 credit and application of the section 960 credit on a current-year basis; and
- Change the source rules for the sale of inventory property.

Finally, and unlike the prior versions of the bill, the Act does not repeal section 956, does not make permanent section 954(c)(6), and does not accelerate the election to allocate interest expense on a worldwide basis.

Financial reporting implications

President Trump signed the Act into law on December 22, 2017, and that action constitutes enactment of the law as contemplated by ASC 740. Accordingly, entities will need to account for the effects of the change in tax law effective in the quarter that includes December 22, 2017.

The US Securities and Exchange Commission, however, has also provided regulatory guidance (Staff Accounting Bulletin No. 118, "SAB 118") regarding the accounting impacts of the new law. The guidance contained within SAB 118 follows an implementation approach whereby entities would follow something similar to the measurement period in a business combination. More specifically, an entity would recognize those matters for which the accounting can be completed, as might be the case for the effect of rate changes on deferred tax assets and deferred tax liabilities. For those matters that have not been completed, the entity would recognize provisional amounts and then adjust them over time as more information becomes available, along with robust disclosures.

Tax law changes with significant financial statement impact

The Act includes significant changes to US tax law and will have a significant impact on companies' financial statements. We expect the more significant impacts to include the following:

- Deferred tax assets and liabilities (DTAs and DTLs), including those related to items initially recorded through other comprehensive income and shareholders' equity, will need to be remeasured for the impact of the corporate rate reduction, and any adjustments are included in income from continuing operations for the period that includes the enactment date.

- For a fiscal-year-end entity, pursuant to IRC section 15, a blended tax rate will apply to the taxable year that includes the enactment date. Accordingly, deferred taxes as of the enactment date for a fiscal-year-end entity that are expected to reverse in the current fiscal year should be measured at the blended tax rate and those expected to reverse in future years should be measured at the new 21 percent statutory rate. The effect of this remeasurement is recorded discretely in the period of enactment. The effect of the tax rate change on taxes currently payable or refundable is reflected after the effective dates prescribed in the statutes in the computation of the annual effective tax rate beginning no earlier than the first interim period that includes the enactment date of the new legislation. Because the tax rate reduction is administratively applied to an entity with a fiscal year- end by applying the blended tax rate to the taxable income for the full fiscal year, the change in tax rate is effective at the beginning of the fiscal year.

- An entity that historically asserted that it is indefinitely reinvested in the outside basis difference in a foreign subsidiary or foreign corporate joint venture that is essentially permanent in duration will likely be required to recognize a liability on account of the provision mandating a deemed repatriation of foreign earnings and profits. Entities that had not previously determined that they were indefinitely reinvested in the outside basis difference in a foreign investment will likely need to remeasure existing deferred tax liabilities recognized for the foreign investment because the tax due as a result of this provision will likely be different than the tax liability that would have been due if the outside basis difference reversed under prior law. If the entity elects to pay the related tax liability over an eight-year period, a portion of the liability may be classified as noncurrent.

- A US entity may experience an increase in US taxable income under anti-base erosion provisions. Additionally, certain global intangible low-taxed income will be currently taxable and payments to related foreign parties will not be deductible under the Base Erosion and Anti-Abuse Tax. These provisions could impact an entity's prospective effective tax rate. The entity will need to consider whether and how US deferred taxes should be recorded if it expects to have a taxable income inclusion under the GILTI provision or have income subject to the new BEAT provisions.

- Several provisions in the new law either eliminate or limit deductions and tax credits (e.g., interest expense limitations, modifications to net operating losses, loss of business deductions and credits) that could unfavorably affect an entity's effective tax rate and negatively impact earnings. These provisions, as well as those discussed above, could also affect valuation allowance analyses and related disclosures.

To the extent potential income tax reform could materially affect the company or its business, SEC registrants should also consider possible disclosure requirements under Risk Factors and Management's discussion and analysis of financial condition and results of operations.

Frequently asked questions

A financial reporting alert dated January 3, 2018, and prepared by the ASC 740 group at Deloitte Tax addresses a number of frequently asked questions related to the accounting implications of the Act.

Talk to Us

Please visit **www.deloitte.com/us/jsg** for additional information about Deloitte's Japanese Services Group. If you have questions or comments regarding the content of this newsletter, please contact one of the following leaders:

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