

**Corporate Taxation
Spring 2018
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**Statutory Supplement for
Public Law 115-97
(Tax Cuts and Jobs Act of 2017)**

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Selected Corporate Tax Changes to Internal Revenue Code from Public Law 115-97

Public Law 115-97, also known as the Tax Cuts and Jobs Act of 2017 and referred to herein as “the Act,” was enacted on Dec. 22, 2017. The Act made numerous changes to the Internal Revenue Code of 1986 (“IRC”). Changes applicable to corporations and their shareholders are reproduced here.

Code § 1. Tax imposed

The Act added a new subsection (j) to IRC § 1, as follows.

(j) Modifications for taxable years 2018 through 2025.—

(1) In general.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

(A) subsection (i) shall not apply, and

(B) this section (other than subsection (i)) shall be applied as provided in paragraphs (2) through (6).

(2) Rate tables.—

(A) Married individuals filing joint returns and surviving spouses.—The following table shall be applied in lieu of the table contained in subsection (a):

If taxable income is:	The tax is:
Not over \$19,050	10% of taxable income.
Over \$19,050 but not over \$77,400	\$1,905, plus 12% of the excess over \$19,050.
Over \$77,400 but not over \$165,000	\$8,907, plus 22% of the excess over \$77,400.
Over \$165,000 but not over \$315,000	\$28,179, plus 24% of the excess over \$165,000.
Over \$315,000 but not over \$400,000	\$64,179, plus 32% of the excess over \$315,000.
Over \$400,000 but not over \$600,000	\$91,379, plus 35% of the excess over \$400,000.
Over \$600,000	\$161,379, plus 37% of the excess over \$600,000.

(B) Heads of households.—The following table shall be applied in lieu of the table contained in subsection (b):

If taxable income is:	The tax is:
Not over \$13,600	10% of taxable income.
Over \$13,600 but not over \$51,800	\$1,360, plus 12% of the excess over \$13,600.
Over \$51,800 but not over \$82,500	\$5,944, plus 22% of the excess over \$51,800.
Over \$82,500 but not over \$157,500	\$12,698, plus 24% of the excess over \$82,500.
Over \$157,500 but not over \$200,000	\$30,698, plus 32% of the excess over \$157,500.
Over \$200,000 but not over \$500,000.....	\$44,298, plus 35% of the excess over \$200,000.
Over \$500,000	\$149,298, plus 37% of the excess over \$500,000.

(C) Unmarried individuals other than surviving spouses and heads of households.—The following table shall be applied in lieu of the table contained in subsection (c):

If taxable income is:	The tax is:
Not over \$9,525	10% of taxable income.
Over \$9,525 but not over \$38,700	\$952.50, plus 12% of the excess over \$9,525.
Over \$38,700 but not over \$82,500	\$4,453.50, plus 22% of the excess over \$38,700.
Over \$82,500 but not over \$157,500	\$14,089.50, plus 24% of the excess over \$82,500.
Over \$157,500 but not over \$200,000	\$32,089.50, plus 32% of the excess over \$157,500.
Over \$200,000 but not over \$500,000.....	\$45,689.50, plus 35% of the excess over \$200,000.
Over \$500,000	\$150,689.50, plus 37% of the excess over \$500,000.

(D) Married individuals filing separate returns.—The following table shall be applied in lieu of the table contained in subsection (d):

If taxable income is:	The tax is:
Not over \$9,525	10% of taxable income.
Over \$9,525 but not over \$38,700	\$952.50, plus 12% of the excess over \$9,525.
Over \$38,700 but not over \$82,500	\$4,453.50, plus 22% of the excess over \$38,700.
Over \$82,500 but not over \$157,500	\$14,089.50, plus 24% of the excess over \$82,500.
Over \$157,500 but not over \$200,000	\$32,089.50, plus 32% of the excess over \$157,500.
Over \$200,000 but not over \$500,000.....	\$45,689.50, plus 35% of the excess over \$200,000.
Over \$300,000	\$80,689.50, plus 37% of the excess over \$300,000.

(E) Estates and trusts.—The following table shall be applied in lieu of the table contained in subsection (e):

If taxable income is:	The tax is:
Not over \$2,550	10% of taxable income.
Over \$2,550 but not over \$9,150	\$255, plus 24% of the excess over \$2,550.
Over \$9,150 but not over \$12,500	\$1,839, plus 35% of the excess over \$9,150.
Over \$12,500	\$3,011.50, plus 37% of the excess over \$12,500

(end of table)

* * * * *

These tables are in effect for the taxable year 2018. Thereafter, inflation adjustments under IRC § 1(f) are scheduled to kick in, with 2017 being the baseline year for determining future inflation.

Code § 11. Tax imposed

The Act amended subsection (b) of IRC § 11 to read in its entirety as follows.

(b) Amount of tax.—The amount of the tax imposed by subsection (a) shall be 21 percent of taxable income.

Code § 55. Alternative minimum tax imposed

The Act amended IRC § 55 so that it no longer applies to corporations. Thus, the corporate alternative minimum tax is repealed.

Code § 118. Contributions to capital of a corporation

The Act made numerous changes to IRC § 118. As amended, IRC § 118 reads in its entirety as follows.

SEC. 118. CONTRIBUTIONS TO CAPITAL OF A CORPORATION

(a) General rule.—In the case of a corporation, gross income does not include any contribution to the capital of the taxpayer.

(b) Exceptions.—For purposes of subsection (a), the term “contribution to the capital of the taxpayer” does not include—

- (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and
- (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).

(c) Regulations.—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out this section, including regulations or other guidance for determining whether any contribution constitutes a contribution in aid of construction..

(d) Cross references.—

- (1) **For basis of property acquired by a corporation through a contribution to its capital, see section 362.**
- (2) **For special rules in the case of contributions of indebtedness, see section 108(e)(6).**

Code § 163. Interest

The Act amended subsection (j) of IRC § 163 to read as follows.

(j) Limitation on business interest.—

(1) In general.—The amount allowed as a deduction under this chapter for any taxable year for business interest shall not exceed the sum of—

- (A) the business interest income of such taxpayer for such taxable year,
- (B) 30 percent of the adjusted taxable income of such taxpayer for such taxable year, plus
- (C) the floor plan financing interest of such taxpayer for such taxable year.

The amount determined under subparagraph (B) shall not be less than zero.

(2) Carryforward of disallowed business interest.— The amount of any business interest not allowed as a deduction for any taxable year by reason of paragraph (1) shall be treated as business interest paid or accrued in the succeeding taxable year.

(3) Exemption for certain small businesses.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, paragraph (1) shall not apply to such taxpayer for such taxable year. In the case of any taxpayer

which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if such taxpayer were a corporation or partnership.

(4) Application to partnerships, etc.—

(A) In general.—In the case of any partnership—

(i) this subsection shall be applied at the partnership level and any deduction for business interest shall be taken into account in determining the non-separately stated taxable income or loss of the partnership, and

(ii) the adjusted taxable income of each partner of such partnership—

(I) shall be determined without regard to such partner's distributive share of any items of income, gain, deduction, or loss of such partnership, and

(II) shall be increased by such partner's distributive share of such partnership's excess taxable income.

For purposes of clause (ii)(II), a partner's distributive share of partnership excess taxable income shall be determined in the same manner as the partner's distributive share of nonseparately stated taxable income or loss of the partnership.

(B) Special rules for carryforwards.—

(i) **In general.—**The amount of any business interest not allowed as a deduction to a partnership for any taxable year by reason of paragraph (1) for any taxable year—

(I) shall not be treated under paragraph (2) as business interest paid or accrued by the partnership in the succeeding taxable year, and

(II) shall, subject to clause (ii), be treated as excess business interest which is allocated to each partner in the same manner as the nonseparately stated taxable income or loss of the partnership.

(ii) **Treatment of excess business interest allocated to partners.—**If a partner is allocated any excess business interest from a partnership under clause (i) for any taxable year—

(I) such excess business interest shall be treated as business interest paid or accrued by the partner in the next succeeding taxable year in which the partner is allocated excess taxable income from such partnership, but only to the extent of such excess taxable income, and

(II) any portion of such excess business interest remaining after the application of subclause (I) shall, subject to the limitations of subclause (I), be treated as business interest paid or accrued in succeeding taxable years.

For purposes of applying this paragraph, excess taxable income allocated to a partner from a partnership for any taxable year shall not be taken into account under paragraph (1)(A) with respect to any business interest other than excess business interest from the partnership until all such excess business interest for such taxable year and all preceding taxable years has been treated as paid or accrued under clause (ii).

(iii) Basis adjustments.—

(I) In general.—The adjusted basis of a partner in a partnership interest shall be reduced (but not below zero) by the amount of excess business interest allocated to the partner under clause (i)(II).

(II) Special rule for dispositions.—If a partner disposes of a partnership interest, the adjusted basis of the partner in the partnership interest shall be increased immediately before the disposition by the amount of the excess (if any) of the amount of the basis reduction under subclause (I) over the portion of any excess business interest allocated to the partner under clause (i)(II) which has previously been treated under clause (ii) as business interest paid or accrued by the partner. The preceding sentence shall also apply to transfers of the partnership interest (including by reason of death) in a transaction in which gain is not recognized in whole or in part. No deduction shall be allowed to the transferor or transferee under this chapter for any excess business interest resulting in a basis increase under this subclause.

(C) Excess taxable income.—The term “excess taxable income” means, with respect to any partnership, the amount which bears the same ratio to the partnership’s adjusted taxable income as—

(i) the excess (if any) of—

(I) the amount determined for the partnership under paragraph (1)(B), over

(II) the amount (if any) by which the business interest of the partnership, reduced by the floor plan financing interest, exceeds the business interest income of the partnership, bears to

(ii) the amount determined for the partnership under paragraph (1)(B).

(D) Application to S corporations.—Rules similar to the rules of subparagraphs (A) and (C) shall apply with respect to any S corporation and its shareholders.

(5) Business interest.—For purposes of this subsection, the term “business interest” means any interest paid or accrued on indebtedness properly allocable to a trade or business. Such term shall not include investment interest (within the meaning of subsection (d)).

(6) Business interest income.—For purposes of this subsection, the term “business interest income” means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Such term shall not include investment income (within the meaning of subsection (d)).

(7) Trade or business.—For purposes of this subsection—

(A) In general.—The term “trade or business” shall not include—

- (i)** the trade or business of performing services as an employee,
- (ii)** any electing real property trade or business,
- (iii)** any electing farming business, or
- (iv)** the trade or business of the furnishing or sale of—
 - (I)** electrical energy, water, or sewage disposal services,
 - (II)** gas or steam through a local distribution system, or
 - (III)** transportation of gas or steam by pipeline * * * * * .

(B) Electing real property trade or business.—For purposes of this paragraph, the term “electing real property trade or business” means any trade or business which is described in section 469(c)(7)(C) and which makes an election under this subparagraph. Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

* * * * *

(8) Adjusted taxable income.—For purposes of this subsection, the term “adjusted taxable income” means the taxable income of the taxpayer—

(A) computed without regard to—

- (i)** any item of income, gain, deduction, or loss which is not properly allocable to a trade or business,
- (ii)** any business interest or business interest income,
- (iii)** the amount of any net operating loss deduction under section 172,

(iv) the amount of any deduction allowed under section 199A, and

(v) in the case of taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion, and

(B) computed with such other adjustments as provided by the Secretary.

(9) Floor plan financing interest defined.—For purposes of this subsection—

(A) In general.—The term “floor plan financing interest” means interest paid or accrued on floor plan financing indebtedness.

(B) Floor plan financing indebtedness.—The term “floor plan financing indebtedness” means indebtedness—

(i) used to finance the acquisition of motor vehicles held for sale or lease, and

(ii) secured by the inventory so acquired.

* * * * *

(10) Cross references.—

(A) For requirement that an electing real property trade or business use the alternative depreciation system, see section 168(g)(1)(F).

(B) For requirement that an electing farming business use the alternative depreciation system, see section 168(g)(1)(G).

Code § 168. Accelerated cost recovery system

The Act made numerous changes to subsection (k) of IRC § 168. As amended, IRC § 168(k) reads as follows.

(k) Special allowance for certain property.

(1) Additional allowance.—In the case of any qualified property—

(A) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to the applicable percentage of the adjusted basis of the qualified property, and

(B) the adjusted basis of the qualified property shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

(2) **Qualified property.**—For purposes of this subsection—

(A) **In general.** The term “qualified property” means property—

(i)

(I) to which this section applies which has a recovery period of 20 years or less,

(II) which is computer software (as defined in section 167(f)(1)(B)) for which a deduction is allowable under section 167(a) without regard to this subsection,

(III) which is water utility property,

(IV) which is a qualified film or television production (as defined in subsection (d) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection, or

(V) which is a qualified live theatrical production (as defined in subsection (e) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection,

(ii) the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of clause (ii) of subparagraph (E), and

(iii) which is placed in service by the taxpayer before January 1, 2027.

(B) **Certain property having longer production periods treated as qualified property.**—

(i) **In general.** The term “qualified property” includes any property if such property—

(I) meets the requirements of clauses (i) and (ii) of subparagraph (A),

(II) is placed in service by the taxpayer before January 1, 2028,

(III) is acquired by the taxpayer (or acquired pursuant to a written contract entered into) before January 1, 2027,

(IV) has a recovery period of at least 10 years or is transportation property,

(V) is subject to section 263A, and

(VI) meets the requirements of clause (iii) of section 263A(f)(1)(B) (determined as if such clause also applies to property which has a long useful life (within the meaning of section 263A(f))).

(ii) **Only pre-January 1, 2027 basis eligible for additional allowance.**—In the case of property which is qualified property solely by reason of clause (i), paragraph (1) shall apply only to the extent of the adjusted basis thereof attributable to manufacture, construction, or production before January 1, 2027.

(iii) **Transportation property.**—For purposes of this subparagraph, the term “transportation property” means tangible personal property used in the trade or business of transporting persons or property.

(iv) **Application of subparagraph.**—This subparagraph shall not apply to any property which is described in subparagraph (C).

(C) **Certain aircraft.**—The term “qualified property” includes property—

(i) which meets the requirements of subparagraph (A)(ii) and subclauses (II) and (III) of subparagraph (B)(i),

(ii) which is an aircraft which is not a transportation property (as defined in subparagraph (B)(iii)) other than for agricultural or firefighting purposes,

(iii) which is purchased and on which such purchaser, at the time of the contract for purchase, has made a nonrefundable deposit of the lesser of—

(I) 10 percent of the cost, or

(II) \$100,000, and

(iv) which has—

(I) an estimated production period exceeding 4 months, and

(II) a cost exceeding \$200,000.

(D) **Exception for alternative depreciation property.**—The term “qualified property” shall not include any property to which the alternative depreciation system under subsection (g) applies, determined—

(i) without regard to paragraph (7) of subsection (g) (relating to election to have system apply), and

(ii) after application of section 280F(b) (relating to listed property with limited business use).

(E) Special rules.—

(i) Self-constructed property.—In the case of a taxpayer manufacturing, constructing, or producing property for the taxpayer’s own use, the requirements of subclause (III) of subparagraph (B)(i) shall be treated as met if the taxpayer begins manufacturing, constructing, or producing the property before January 1, 2027.

(ii) Acquisition requirements.—An acquisition of property meets the requirements of this clause if—

(I) such property was not used by the taxpayer at any time prior to such acquisition, and

(II) the acquisition of such property meets the requirements of paragraphs (2)(A), (2)(B), (2)(C), and (3) of section 179(d).

(iii) Syndication.—For purposes of subparagraph (A)(ii), if—

(I) property is used by a lessor of such property and such use is the lessor’s first use of such property,

(II) such property is sold by such lessor or any subsequent purchaser within 3 months after the date such property was originally placed in service (or, in the case of multiple units of property subject to the same lease, within 3 months after the date the final unit is placed in service, so long as the period between the time the first unit is placed in service and the time the last unit is placed in service does not exceed 12 months), and

(III) the user of such property after the last sale during such 3-month period remains the same as when such property was originally placed in service,

such property shall be treated as originally placed in service not earlier than the date of such last sale.

(F) Coordination with section 280F.—For purposes of section 280F—

(i) Automobiles.—In the case of a passenger automobile (as defined in section 280F(d)(5)) which is qualified property, the Secretary shall increase the limitation under section 280F(a)(1)(A)(i) by \$8,000.

(ii) Listed property.—The deduction allowable under paragraph (1) shall be taken into account in computing any recapture amount under section 280F(b)(2).

(iii) Phase down.—In the case of a passenger automobile acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017, clause (i) shall be applied by substituting for “\$8,000”—

(I) in the case of an automobile placed in service during 2018, \$6,400, and

(II) in the case of an automobile placed in service during 2019, \$4,800.

(G) Deduction allowed in computing minimum tax.—For purposes of determining alternative minimum taxable income under section 55, the deduction under section 167 for qualified property shall be determined without regard to any adjustment under section 56 .

(H) Production placed in service.—For purposes of subparagraph (A) —

(i) a qualified film or television production shall be considered to be placed in service at the time of initial release or broadcast, and

(ii) a qualified live theatrical production shall be considered to be placed in service at the time of the initial live staged performance.

(3) Repealed

(4) Repealed

(5) Special rules for certain plants bearing fruits and nuts.—

(A) In general.—In the case of any specified plant which is planted before January 1, 2027, or is grafted before such date to a plant that has already been planted, by the taxpayer in the ordinary course of the taxpayer’s farming business (as defined in section 263A(e)(4)) during a taxable year for which the taxpayer has elected the application of this paragraph—

(i) a depreciation deduction equal to the applicable percentage of the adjusted basis of such specified plant shall be allowed under section 167(a) for the taxable year in which such specified plant is so planted or grafted, and

(ii) the adjusted basis of such specified plant shall be reduced by the amount of such deduction.

* * * * *

(6) Applicable percentage.—For purposes of this subsection—

(A) In general.—Except as otherwise provided in this paragraph, the term “applicable percentage” means—

(i) in the case of property placed in service after September 27, 2017, and before January 1, 2023, 100 percent,

(ii) in the case of property placed in service after December 31, 2022, and before January 1, 2024, 80 percent,

(iii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 60 percent,

(iv) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 40 percent, and

(v) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 20 percent.

(B) Rule for property with longer production periods. In the case of property described in subparagraph (B) or (C) of paragraph (2), the term “applicable percentage” means—

(i) in the case of property placed in service after September 27, 2017, and before January 1, 2024, 100 percent,

(ii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 80 percent,

(iii) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 60 percent,

(iv) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 40 percent, and

(v) in the case of property placed in service after December 31, 2026, and before January 1, 2028, 20 percent.

* * * * *

(7) Election out.—If a taxpayer makes an election under this paragraph with respect to any class of property for any taxable year, paragraphs (1) and (2)(F) shall not apply to any qualified property in such class placed in service during such taxable year. An election under this paragraph may be revoked only with the consent of the Secretary.

(8) Phase down.—In the case of qualified property acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017, paragraph (6) shall be applied by substituting for each percentage therein—

(A) “50 percent” in the case of—

(i) property placed in service before January 1, 2018, and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2018,

(B) “40 percent” in the case of—

(i) property placed in service in 2018 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2019,

(C) "30 percent" in the case of—

(i) property placed in service in 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2020, and

(D) "0 percent" in the case of—

(i) property placed in service after 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service after 2020.

(9) Exception for certain property.—The term "qualified property" shall not include—

(A) any property which is primarily used in a trade or business described in clause (iv) of section 163(j)(7)(A), or

(B) any property used in a trade or business that has had floor plan financing indebtedness (as defined in paragraph (9) of section 163(j)), if the floor plan financing interest related to such indebtedness was taken into account under paragraph (1)(C) of such section.

(10) Special rule for property placed in service during certain periods.—

(A) **In general.**—In the case of qualified property placed in service by the taxpayer during the first taxable year ending after September 27, 2017, if the taxpayer elects to have this paragraph apply for such taxable year, paragraphs (1)(A) and (5)(A)(i) shall be applied by substituting "50 percent" for "the applicable percentage".

(B) **Form of election.**—Any election under this paragraph shall be made at such time and in such form and manner as the Secretary may prescribe.

Code § 199. Income attributable to domestic production activities

The Act repealed IRC § 199.

Code § 199A. Qualified business income

The Act added new IRC § 199A, as follows.

SEC. 199A. QUALIFIED BUSINESS INCOME.

(a) In general.—In the case of a taxpayer other than a corporation, there shall be allowed as a deduction for any taxable year an amount equal to the sum of—

(1) the lesser of—

(A) the combined qualified business income amount of the taxpayer, or

(B) an amount equal to 20 percent of the excess (if any) of—

(i) the taxable income of the taxpayer for the taxable year, over

(ii) the sum of any net capital gain (as defined in section 1(h)), plus the aggregate amount of the qualified cooperative dividends, of the taxpayer for the taxable year, plus

(2) the lesser of—

(A) 20 percent of the aggregate amount of the qualified cooperative dividends of the taxpayer for the taxable year, or

(B) taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

The amount determined under the preceding sentence shall not exceed the taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

(b) Combined qualified business income amount.—For purposes of this section—

(1) In general.—The term “combined qualified business income amount” means, with respect to any taxable year, an amount equal to—

(A) the sum of the amounts determined under paragraph (2) for each qualified trade or business carried on by the taxpayer, plus

(B) 20 percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the taxable year.

(2) Determination of deductible amount for each trade or business.—The amount determined under this paragraph with respect to any qualified trade or business is the lesser of—

(A) 20 percent of the taxpayer’s qualified business income with respect to the qualified trade or business, or

(B) the greater of—

(i) 50 percent of the W–2 wages with respect to the qualified trade or business, or

(ii) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

(3) Modifications to limit based on taxable income.—

(A) **Exception from limit.**—In the case of any taxpayer whose taxable income for the taxable year does not exceed the threshold amount, paragraph (2) shall be applied without regard to subparagraph (B).

(B) **Phase-in of limit for certain taxpayers.**—

(i) **In general.**—If—

(I) the taxable income of a taxpayer for any taxable year exceeds the threshold amount, but does not exceed the sum of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return), and

(II) the amount determined under paragraph (2)(B) (determined without regard to this subparagraph) with respect to any qualified trade or business carried on by the taxpayer is less than the amount determined under paragraph (2)(A) with respect such trade or business,

then paragraph (2) shall be applied with respect to such trade or business without regard to subparagraph (B) thereof and by reducing the amount determined under subparagraph (A) thereof by the amount determined under clause (ii).

(ii) **Amount of reduction.**—The amount determined under this subparagraph is the amount which bears the same ratio to the excess amount as—

(I) the amount by which the taxpayer’s taxable income for the taxable year exceeds the threshold amount, bears to

(II) \$50,000 (\$100,000 in the case of a joint return).

(iii) Excess amount.—For purposes of clause (ii), the excess amount is the excess of—

(I) the amount determined under paragraph (2)(A) (determined without regard to this paragraph), over

(II) the amount determined under paragraph (2)(B) (determined without regard to this paragraph).

(4) Wages, etc.—

(A) In general.—The term “W-2 wages” means, with respect to any person for any taxable year of such person, the amounts described in paragraphs (3) and (8) of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

(B) Limitation to wages attributable to qualified business income.—Such term shall not include any amount which is not properly allocable to qualified business income for purposes of subsection (c)(1).

(C) Return requirement.—Such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

(5) Acquisitions, dispositions, and short taxable years.—The Secretary shall provide for the application of this subsection in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

(6) Qualified property.—For purposes of this section:

(A) In general.—The term “qualified property” means, with respect to any qualified trade or business for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167—

(i) which is held by, and available for use in, the qualified trade or business at the close of the taxable year,

(ii) which is used at any point during the taxable year in the production of qualified business income, and

(iii) the depreciable period for which has not ended before the close of the taxable year.

(B) Depreciable period.—The term “depreciable period” means, with respect to qualified property of a taxpayer, the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of—

(i) the date that is 10 years after such date, or

(ii) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (determined without regard to subsection (g) thereof).

(c) Qualified business income.—For purposes of this section—

(1) In general.—The term “qualified business income” means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Such term shall not include any qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income.

(2) Carryover of losses.—If the net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year.

(3) Qualified items of income, gain, deduction, and loss.—For purposes of this subsection—

(A) In general.—The term “qualified items of income, gain, deduction, and loss” means items of income, gain, deduction, and loss to the extent such items are—

(i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting “qualified trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or for “a foreign corporation” each place it appears), and

(ii) included or allowed in determining taxable income for the taxable year.

(B) Exceptions.—The following investment items shall not be taken into account as a qualified item of income, gain, deduction, or loss:

(i) Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.

(ii) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G).

(iii) Any interest income other than interest income which is properly allocable to a trade or business.

(iv) Any item of gain or loss described in subparagraph (C) or (D) of section 954(c)(1) (applied by substituting “qualified trade or business” for “controlled foreign corporation”).

(v) Any item of income, gain, deduction, or loss taken into account under section 954(c)(1)(F) (determined without regard to clause (ii) thereof and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7)).

(vi) Any amount received from an annuity which is not received in connection with the trade or business.

(vii) Any item of deduction or loss properly allocable to an amount described in any of the preceding clauses.

(4) Treatment of reasonable compensation and guaranteed payments.—Qualified business income shall not include—

(A) reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business,

(B) any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and

(C) to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business.

(d) Qualified trade or business.—For purposes of this section—

(1) In general.—The term “qualified trade or business” means any trade or business other than—

(A) a specified service trade or business, or

(B) the trade or business of performing services as an employee.

(2) Specified service trade or business.—The term “specified service trade or business” means any trade or business—

(A) which is described in section 1202(e)(3)(A) (applied without regard to the words “engineering, architecture,”) or which would be so described if the term “employees or owners” were substituted for “employees” therein, or

(B) which involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

(3) Exception for specified service businesses based on taxpayer’s income.—

(A) In general.—If, for any taxable year, the taxable income of any taxpayer is less than the sum of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return), then—

(i) any specified service trade or business of the taxpayer shall not fail to be treated as a qualified trade or business due to paragraph (1)(A), but

(ii) only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W-2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W-2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer for the taxable year for purposes of applying this section.

(B) Applicable percentage.—For purposes of subparagraph (A), the term “applicable percentage” means, with respect to any taxable year, 100 percent reduced (not below zero) by the percentage equal to the ratio of—

(i) the taxable income of the taxpayer for the taxable year in excess of the threshold amount, bears to

(ii) \$50,000 (\$100,000 in the case of a joint return).

(e) Other definitions.—For purposes of this section—

(1) Taxable income.—Taxable income shall be computed without regard to the deduction allowable under this section.

(2) Threshold amount.—

(A) In general.—The term “threshold amount” means \$157,500 (200 percent of such amount in the case of a joint return).

(B) Inflation adjustment.—In the case of any taxable year beginning after 2018, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting “calendar year 2017” for “calendar year 2016” in subparagraph (A)(ii) thereof.

The amount of any increase under the preceding sentence shall be rounded as provided in section 1(f)(7).

* * * * *

(5) Qualified publicly traded partnership income.—The term “qualified publicly traded partnership income” means, with respect to any qualified trade or business of a taxpayer, the sum of—

(A) the net amount of such taxpayer’s allocable share of each qualified item of income, gain, deduction, and loss (as defined in subsection (c)(3) and determined after the application of subsection (c)(4)) from a publicly traded partnership (as defined in section 7704(a)) which is not treated as a corporation under section 7704(c), plus

(B) any gain recognized by such taxpayer upon disposition of its interest in such partnership to the extent such gain is treated as an amount realized from the sale or exchange of property other than a capital asset under section 751(a).

(f) Special rules.—

(1) Application to partnerships and S corporations.—

(A) **In general.**—In the case of a partnership or S corporation—

(i) this section shall be applied at the partner or shareholder level,

(ii) each partner or shareholder shall take into account such person’s allocable share of each qualified item of income, gain, deduction, and loss, and

(iii) each partner or shareholder shall be treated for purposes of subsection (b) as having W-2 wages and unadjusted basis immediately after acquisition of qualified property for the taxable year in an amount equal to such person’s allocable share of the W-2 wages and the unadjusted basis immediately after acquisition of qualified property of the partnership or S corporation for the taxable year (as determined under regulations prescribed by the Secretary).

For purposes of clause (iii), a partner’s or shareholder’s allocable share of W-2 wages shall be determined in the same manner as the partner’s or shareholder’s allocable share of wage expenses. For purposes of such clause, partner’s or shareholder’s allocable share of the unadjusted basis immediately after acquisition of qualified property shall be determined in the same manner as the partner’s or shareholder’s allocable share of depreciation. For purposes of this subparagraph, in the case of an S corporation, an allocable share shall be the shareholder’s pro rata share of an item.

(B) **Application to trusts and estates.**—Rules similar to the rules under section 199(d)(1)(B)(i) (as in effect on December 1, 2017) for the apportionment of W-2 wages shall apply to the apportionment of W-2 wages and the apportionment of unadjusted basis immediately after acquisition of qualified property under this section.

* * * * *

(2) Coordination with minimum tax.—For purposes of determining alternative minimum taxable income under section 55, qualified business income shall be determined without regard to any adjustments under sections 56 through 59.

(3) Deduction limited to income taxes.—The deduction under subsection (a) shall only be allowed for purposes of this chapter.

(4) Regulations.—The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations—

(A) for requiring or restricting the allocation of items and wages under this section and such reporting requirements as the Secretary determines appropriate, and

(B) for the application of this section in the case of tiered entities.

* * * * *

(h) Anti-abuse rules.—The Secretary shall—

(1) apply rules similar to the rules under section 179(d)(2) in order to prevent the manipulation of the depreciable period of qualified property using transactions between related parties, and

(2) prescribe rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions.

(i) Termination.—This section shall not apply to taxable years beginning after December 31, 2025.

The Act also amended IRC §§ 62 and 63 to treat the deduction under IRC § 199A as a below-the-line deduction, but not as an itemized deduction. Therefore the deduction does not decrease the taxpayer's adjusted gross income, but it is available even to taxpayers who take the standard deduction rather than itemizing.

Code § 243. Dividends received by corporations

The Act made numerous changes to IRC § 243. As amended, IRC § 243 reads in relevant part as follows.

SEC. 243. DIVIDENDS RECEIVED BY CORPORATIONS

(a) General rule.—In the case of a corporation, there shall be allowed as a deduction an amount equal to the following percentages of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter:

(1) 50 percent, in the case of dividends other than dividends described in paragraph (2) or (3);

(2) 100 percent, in the case of dividends received by a small business investment company operating under the Small Business Investment Act of 1958 (15 U.S.C. 661 and following); and

(3) 100 percent, in the case of qualifying dividends (as defined in subsection (b)(1)).

(b) Qualifying dividends.—

(1) In general.—For purposes of this section, the term “qualifying dividend” means any dividend received by a corporation—

(A) if at the close of the day on which such dividend is received, such corporation is a member of the same affiliated group as the corporation distributing such dividend, and

(B) if—

(i) such dividend is distributed out of the earnings and profits of a taxable year of the distributing corporation which ends after December 31, 1963, for which an election under section 1562 was not in effect, and on each day of which the distributing corporation and the corporation receiving the dividend were members of such affiliated group, or

(ii) such dividend is paid by a corporation with respect to which an election under section 936 is in effect for the taxable year in which such dividend is paid.

(2) Affiliated group. For purposes of this subsection:

(A) **In general.**—The term “affiliated group” has the meaning given such term by section 1504(a), except that for such purposes sections 1504(b)(2), 1504(b)(4), and 1504(c) shall not apply.

* * * * *

(c) Increased percentage for dividends from 20-percent owned corporations.—

(1) In general.—In the case of any dividend received from a 20-percent owned corporation, subsection (a)(1) shall be applied by substituting “65 percent” for “50 percent”.

(2) 20-percent owned corporation.—For purposes of this section, the term “20-percent owned corporation” means any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer. For purposes of the preceding sentence, stock described in section 1504(a)(4) shall not be taken into account.

* * * * *

Code § 481. Adjustments required by changes in method of accounting

The Act added a new subsection (d) to IRC § 481, as follows.

(d) Adjustments attributable to conversion from S corporation to C corporation.—

(1) In general.—In the case of an eligible terminated S corporation, any adjustment required by subsection (a)(2) which is attributable to such corporation’s revocation described in paragraph (2)(A)(ii) shall be taken into account ratably during the 6-taxable year period beginning with the year of change.

(2) Eligible terminated S corporation.—For purposes of this subsection, the term “eligible terminated S corporation” means any C corporation—

(A) which—

(i) was an S corporation on the day before the date of the enactment of the Tax Cuts and Jobs Act, and

(ii) during the 2-year period beginning on the date of such enactment makes a revocation of its election under section 1362(a), and

(B) the owners of the stock of which, determined on the date such revocation is made, are the same owners (and in identical proportions) as on the date of such enactment.

Code § 1361. S corporation defined

The Act added a new sentence at the end of IRC § 1361(c)(2)(B)(v), so that it reads as follows.

(v) In the case of a trust described in clause (v) of subparagraph (A), each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period. This clause shall not apply for purposes of subsection (b)(1)(C).

Code § 1371. Coordination with subchapter C

The Act added a new subsection (f) to IRC § 1371, as follows.

(f) Cash distributions following post-termination transition period.—In the case of a distribution of money by an eligible terminated S corporation (as defined in section 481(d)) after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in

the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.

Selected Legislative History of Public Law 115-97

Code § 11. Tax imposed

Code § 243. Dividends received by corporations

From House Ways and Means Committee Report, H. Rep. 115-409:

REASONS FOR CHANGE

The United States has one of the highest statutory corporate tax rates among developed countries. The Committee believes that lowering the corporate tax rate is necessary to ensure domestic corporations remain globally competitive with their counterparts domiciled in the United States' largest international competitors. The average corporate income tax rate among nations in the Organisation for Economic Co-operation and Development is 22.5 percent. A low competitive corporate tax rate also contributes to making the United States an attractive location for foreign corporations to invest. In addition, a lower corporate tax rate means corporations will have more resources to invest in growing their businesses and creating jobs.

From Conference Committee Report, H. Rep. 115-466:

1. Reduction in corporate tax rate (sec. 3001 of the House bill, secs. 13001 and 13002 of the Senate amendment, and secs. 11 and 243 of the Code)

Present Law

In general

Corporate taxable income is subject to tax under a four-step graduated rate structure.¹ The top corporate tax rate is 35 percent on taxable income in excess of \$10 million. The corporate taxable income brackets and tax rates are as set forth in the table below.

Taxable Income	Tax rate (percent)
Not over \$50,000	15
Over \$50,000 but not over \$75,000	25
Over \$75,000 but not over \$10,000,000	34
Over \$10,000,000	35

An additional five-percent tax is imposed on a corporation's taxable income in excess of \$100,000. The maximum additional tax is \$11,750. Also, a second additional three-percent tax

¹ Sec. 11(a) and (b)(1).

is imposed on a corporation's taxable income in excess of \$15 million. The maximum second additional tax is \$100,000.

Certain personal service corporations pay tax on their entire taxable income at the rate of 35 percent.²

Present law provides that, if the maximum corporate tax rate exceeds 35 percent, the maximum rate on a corporation's net capital gain will be 35 percent.³

Dividends received deduction

Corporations are allowed a deduction with respect to dividends received from other taxable domestic corporations.⁴ The amount of the deduction is generally equal to 70 percent of the dividend received.

In the case of any dividend received from a 20-percent owned corporation, the amount of the deduction is equal to 80 percent of the dividend received.⁵ The term "20-percent owned corporation" means any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer. For this purpose, certain preferred stock is not taken into account.

In the case of a dividend received from a corporation that is a member of the same affiliated group, a corporation is generally allowed a deduction equal to 100 percent of the dividend received.⁶

House Bill

The provision eliminates the graduated corporate rate structure and instead taxes corporate taxable income at 20 percent.

Personal service corporations are taxed at 25 percent.

The provision repeals the maximum corporate tax rate on net capital gain as obsolete.

The provision reduces the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent.⁷

² Sec. 11(b)(2).

³ Sec. 1201(a).

⁴ Sec. 243(a). Such dividends are taxed at a maximum rate of 10.5 percent (30 percent of the top corporate tax rate of 35 percent).

⁵ Sec. 243(c). Such dividends are taxed at a maximum rate of 7 percent (20 percent of the top corporate tax rate of 35 percent).

⁶ Sec. 243(a)(3) and (b)(1). For this purpose, the term "affiliated group" generally has the meaning given such term by section 1504(a). Sec. 243(b)(2).

For taxpayers subject to the normalization method of accounting (*e.g.*, regulated public utilities), the provision provides for the normalization of excess deferred tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before the date of enactment).

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

Senate Amendment

The Senate amendment follows the House bill, but does not provide a special rate for personal service corporations.

Effective date.—The provision applies to taxable years beginning after December 31, 2018.

Conference Agreement

The conference agreement follows the Senate amendment, but provides for a 21-percent corporate rate effective for taxable years beginning after December 31, 2017.

In addition, for taxpayers subject to the normalization method of accounting (*e.g.*, regulated public utilities), the conference agreement clarifies the normalization of excess tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before the corporate rate reduction takes effect).

* * * * *

⁷ Such dividends would be taxed at a maximum rate of 10 percent (50 percent of the top corporate tax rate of 20 percent) and 7 percent (35 percent of the top corporate tax rate of 20 percent), respectively.

Code § 55. Alternative minimum tax imposed

From House Ways and Means Committee Report, H. Rep. 115-409:

REASONS FOR CHANGE

The requirement that taxpayers compute their income for purposes of both the regular income tax and the AMT is one of the most far-reaching complexities of the Code. The AMT is particularly burdensome for individuals with small businesses, because they often do not know whether they will be affected until they file their taxes and therefore must maintain a reserve that cannot be used to invest in their businesses.

From Conference Committee Report, H. Rep. 115-466:

The conference agreement follows the House bill in repealing the corporate alternative minimum tax.

Code § 118. Contributions to capital of a corporation

From Conference Committee Report, H. Rep. 115-466:

4. Revision of treatment of contributions to capital (sec. 3304 of the House bill and sec. 118 of the Code)

Present Law

The gross income of a corporation does not include any contribution to its capital.⁸ For purposes of this rule, a contribution to the capital of a corporation does not include any contribution in aid of construction or any other contribution from a customer or potential customer.⁹ A special rule allows certain contributions in aid of construction received by a regulated public utility that provides water or sewerage disposal services to be treated as a tax-free contribution to the capital of the utility.¹⁰ No deduction or credit is allowed for, or by reason of, any expenditure that constitutes a contribution that is treated as a tax-free contribution to the capital of the utility.¹¹

If property is acquired by a corporation as a contribution to capital and is not contributed by a shareholder as such, the adjusted basis of the property is zero.¹² If the contribution consists

⁸ Sec. 118(a).

⁹ Sec. 118(b).

¹⁰ Sec. 118(c)(1).

¹¹ Sec. 118(c)(4).

of money, the corporation must first reduce the basis of any property acquired with the contributed money within the following 12-month period, and then reduce the basis of other property held by the corporation.¹³ Similarly, the adjusted basis of any property acquired by a utility with a contribution in aid of construction is zero.¹⁴

House Bill

The provision repeals the provision of the Internal Revenue Code under which, generally, a corporation's gross income does not include contributions of capital to the corporation. The provision provides that a contribution to capital, other than a contribution of money or property made in exchange for stock of a corporation or any interest in an entity, is included in gross income of the corporation. For example, a contribution of municipal land by a municipality that is not in exchange for stock (or for a partnership interest or other interest) of equivalent value is considered a contribution to capital that is includable in gross income. By contrast, a municipal tax abatement for locating a business in a particular municipality is not considered a contribution to capital.

The provision further provides that a contribution of capital in exchange for stock is not includible in the gross income of the corporation to the extent that the fair market value of any money or other property contributed does not exceed the fair market value of stock received. It is intended that, for this purpose, the fair market value of any property contributed is calculated net of any liabilities to which the property is subject and net of any liabilities or obligations of the transferor assumed or taken subject to by the entity in connection with the transaction. When valuing stock or equity received, taxpayers may disregard discounts for lack of control and the effect of limited liquidity on valuation.

The provision does not change the application of the meaningless gesture doctrine, described in *Lessinger v. Commissioner*, 872 F.2d 519 (2d. Cir. 1989) and related cases, as well as in administrative guidance.¹⁵ Thus, under the provision, whether incremental shares of stock are issued when the existing shareholder or shareholders of a corporation make a pro-rata contribution to the capital of the corporation is not determinative of whether the contribution is included in income of the corporation.

The fair market value requirement generally will be satisfied in any arm's length transaction in which stock is issued in consideration for cash. Thus, for example, in a public offering, if the price of the stock was determined on an arm's length basis, the fact the stock trades immediately after its issuance at a price below the issue price will not result in contribution to capital treatment.

Finally, the provision provides rules clarifying the contributee's basis in the property

¹² Sec. 362(c)(1).

¹³ Sec. 362(c)(2). See also Treas. Reg. sec. 1.362-2.

¹⁴ Sec. 118(c)(4).

¹⁵ Rev. Rul. 64-155, 1964-1 CB 138.

contributed.

* * * * *

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the policy of the House bill but takes a different approach. The conference agreement does not repeal the provision of the Internal Revenue Code under which, generally, a corporation's gross income does not include contributions to capital. Rather, it preserves that provision, but provides that the term "contributions to capital" does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such). The conferees intend that section 118, as modified, continue to apply only to corporations.

Code § 163. Interest

From House Ways and Means Committee Report, H. Rep. 115-409:

REASONS FOR CHANGE

The Committee believes that the general deductibility of interest payments on debt may result in companies undertaking more leverage than they would in the absence of the tax system. The effective marginal tax rate on debt-financed investment is lower than that on equity-financed investment.¹⁶ Limiting the deductibility of interest along with reducing the corporate tax rate narrows the disparity in the effective marginal tax rates based on different sources of financing. This leads to a more efficient capital structure for firms. The Committee believes that it is necessary to apply the limitation on the deductibility of interest to businesses regardless of the form in which such businesses are organized so as not to create distortions in the choice of entity.

The Committee believes that limitations on the deductibility of interest should be applied to those businesses with the greatest levels of leverage. Such firms may pose the greatest societal costs in times of financial distress. Smaller firms are likely to impose smaller costs on the economy than larger firms. Additionally, smaller firms have limited access to public equity capital markets as compared to larger firms. Thus, the Committee believes it is appropriate to limit the interest deduction of only the largest taxpayers.

¹⁶ For a discussion of effective marginal tax rates on investment, see Joint Committee on Taxation, *Economic Growth and Tax Policy* (JCX-19-17), May 16, 2017, p. 15ff.

The Committee understands that some taxpayers who do not consistently incur excessive amounts of leverage may nonetheless at times incur an amount of interest expense that is large in relation to its taxable income. For instance, a bad year in a business cycle might reduce taxable income to the point where a limitation based on taxable income takes effect. Furthermore, earnings attributable to investments financed by debt and interest payments associated with such debt may arise in different periods. For that reason, the Committee believes taxpayers should be able to average annual results, and so believes the carryforward of denied interest deductions is appropriate for a period of time.

The Committee recognizes that certain types of trades or businesses have particular characteristics that warrant special rules related to interest deductibility.

From Conference Committee Report, H. Rep. 115-466:

D. Reform of Business Related Exclusions, Deductions, etc.

1. Interest (secs. 3203 and 3301 of the House bill, secs. 13301 and 13311 of the Senate amendment, and sec. 163(j) of the Code)

Present Law

Interest deduction

Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations.¹⁷

Interest is generally deducted by a taxpayer as it is paid or accrued, depending on the taxpayer's method of accounting. For all taxpayers, if an obligation is issued with original issue discount ("OID"), a deduction for interest is allowable over the life of the obligation on a yield to maturity basis.¹⁸ Generally, OID arises where interest on a debt instrument is not calculated based on a qualified rate and required to be paid at least annually.

Investment interest expense

In the case of a taxpayer other than a corporation, the deduction for interest on indebtedness that is allocable to property held for investment ("investment interest") is limited to

¹⁷ Sec. 163(a). In addition to the limitations discussed herein, other limitations include: denial of the deduction for the disqualified portion of the original issue discount on an applicable high yield discount obligation (sec. 163(e)(5)), denial of deduction for interest on certain obligations not in registered form (sec. 163(f)), reduction of the deduction for interest on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 (sec. 163(g)), disallowance of deduction for personal interest (sec. 163(h)), disallowance of deduction for interest on debt with respect to certain life insurance contracts (sec. 264), and disallowance of deduction for interest relating to tax-exempt income (sec. 265). Interest may also be subject to capitalization. See, e.g., sections 263A(f) and 461(g).

¹⁸ Sec. 163(e). But see section 267 (dealing in part with interest paid to a related or foreign party).

the taxpayer's net investment income for the taxable year.¹⁹ Disallowed investment interest is carried forward to the next taxable year.

Net investment income is investment income net of investment expenses. Investment income generally consists of gross income from property held for investment, and investment expense includes all deductions directly connected with the production of investment income (*e.g.*, deductions for investment management fees) other than deductions for interest. The two-percent floor on miscellaneous itemized deductions allows taxpayers to deduct investment expenses connected with investment income only to the extent such deductions exceed two percent of the taxpayer's adjusted gross income ("AGI").²⁰ Miscellaneous itemized deductions²¹ that are not investment expenses are disallowed first before any investment expenses are disallowed.²²

Earnings stripping

Section 163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a taxable year if two threshold tests are satisfied: the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio) and the payor's net interest expense exceeds 50 percent of its adjusted taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Disqualified interest includes interest paid or accrued to: (1) related parties when no Federal income tax is imposed with respect to such interest;²³ (2) unrelated parties in certain instances in which a related party guarantees the debt; or (3) to a real estate investment trust ("REIT") by a taxable REIT subsidiary of that trust.²⁴ Interest amounts disallowed under these rules can be carried forward indefinitely.²⁵ In addition, any excess limitation (*i.e.*, the excess, if any, of 50 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.²⁶

¹⁹ Sec. 163(d).

²⁰ Sec. 67(a).

²¹ Miscellaneous itemized deductions include itemized deductions of individuals other than certain specific itemized deductions. Sec. 67(b). Miscellaneous itemized deductions generally include, for example, investment management fees and certain employee business expenses, but specifically do not include, for example, interest, taxes, casualty and theft losses, charitable contributions, medical expenses, or other listed itemized deductions.

²² H.R. Rep. No. 841, 99th Cong., 2d Sess., p. II-154, Sept. 18, 1986 (Conf. Rep.) ("In computing the amount of expenses that exceed the 2-percent floor, expenses that are not investment expenses are intended to be disallowed before any investment expenses are disallowed.").

²³ If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed by the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

²⁴ Sec. 163(j)(3).

²⁵ Sec. 163(j)(1)(B).

²⁶ Sec. 163(j)(2)(B)(ii).

House Bill

In general

In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of (1) business interest income; (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year; and (3) the floor plan financing interest of the taxpayer for the taxable year. The amount of any business interest not allowed as a deduction for any taxable year may be carried forward for up to five years beyond the year in which the business interest was paid or accrued, treating business interest as allowed as a deduction on a first-in, first-out basis. The limitation applies at the taxpayer level. In the case of a group of affiliated corporations that file a consolidated return, the limitation applies at the consolidated tax return filing level.

Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for purposes of the Internal Revenue Code is interest for purposes of the provision. Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Business interest does not include investment interest, and business interest income does not include investment income, within the meaning of section 163(d).²⁷

Adjusted taxable income means the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the amount of any net operating loss deduction; and (4) any deduction allowable for depreciation, amortization, or depletion.²⁸ The Secretary may provide other adjustments to the computation of adjusted taxable income.

Floor plan financing interest means interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness means indebtedness used to finance the acquisition of motor vehicles held for sale to retail customers and secured by the inventory so acquired. A motor vehicle means a motor vehicle that is an automobile, a truck, a recreational vehicle, a motorcycle, a boat, farm machinery or equipment, or construction machinery or equipment.

By including business interest income and floor plan financing interest in the limitation, the rule operates to allow floor plan financing interest to be fully deductible and to limit the deduction for net interest expense (less floor plan financing interest) to 30 percent of adjusted taxable income. That is, a deduction for business interest is permitted to the full extent of

²⁷ Section 163(d) applies in the case of a taxpayer other than a corporation. Thus, a corporation has neither investment interest nor investment income within the meaning of section 163(d). Thus, interest income and interest expense of a corporation is properly allocable to a trade or business, unless such trade or business is otherwise explicitly excluded from the application of the provision.

²⁸ Any deduction allowable for depreciation, amortization, or depletion includes any deduction allowable for any amount treated as depreciation, amortization, or depletion under present law.

business interest income and any floor plan financing interest. To the extent that business interest exceeds business interest income and floor plan financing interest, the deduction for the net interest expense is limited to 30 percent of adjusted taxable income.

It is generally intended that, similar to present law, section 163(j) apply after the application of provisions that subject interest to deferral, capitalization, or other limitation. Thus, section 163(j) applies to interest deductions that are deferred, for example under section 163(e) or section 267(a)(3)(B), in the taxable year to which such deductions are deferred. Section 163(j) applies after section 263A is applied to capitalize interest and after, for example, section 265 or section 279 is applied to disallow interest.

Application to passthrough entities

In general

In the case of any partnership, the limitation is applied at the partnership level. Any deduction for business interest is taken into account in determining the nonseparately stated taxable income or loss of the partnership.²⁹ To prevent double counting, special rules are provided for the determination of the adjusted taxable income of each partner of the partnership. Similarly, to allow for additional interest deduction by a partner in the case of an excess amount of unused adjusted taxable income limitation of the partnership, special rules apply. Similar rules apply with respect to any S corporation and its shareholders.

Double counting rule

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

Example 1.—ABC is a partnership owned 50-50 by XYZ Corporation and an individual. ABC generates \$200 of noninterest income. Its only expense is \$60 of business interest. Under the provision the deduction for business interest is limited to 30 percent of adjusted taxable income, that is, 30 percent * \$200 = \$60. ABC deducts \$60 of business interest and reports ordinary business income of \$140. XYZ's distributive share of the ordinary business income of ABC is \$70. XYZ has net taxable income of zero from its other operations, none of which is attributable to interest income and without regard to its business interest expense. XYZ has business interest expense of \$25. In the absence of any special rule, the \$70 of taxable income from its interest in ABC would permit the deduction of up to an additional \$21 of interest (30 percent * \$70 = \$21), resulting in a deduction disallowance of only \$4. XYZ's \$100 share of ABC's adjusted taxable income would generate \$51 of interest deductions. If XYZ were instead a passthrough entity, additional deductions could be available at each tier.

²⁹ This amount is the "Ordinary business income or loss" reflected on Form 1065 (U.S. Return of Partnership Income). The partner's distributive share is reflected in Box 1 of Schedule K-1 (Form 1065).

The double counting rule provides that XYZ has adjusted taxable income computed without regard to the \$70 distributive share of the nonseparately stated income of ABC. As a result, XYZ has adjusted taxable income of \$0. XYZ's deduction for business interest is limited to 30 percent * \$0 = \$0, resulting in a deduction disallowance of \$25.

Additional deduction limit

The limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess amount of unused adjusted taxable income limitation. The excess amount with respect to any partnership is the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership (reduced by floor plan financing interest) exceeds the business interest income of the partnership. This allows a partner of a partnership to deduct more interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest.

Example 2.—The facts are the same as in Example 1 except ABC has only \$40 of business interest. As in Example 1, ABC has a limit on its interest deduction of \$60. The excess amount for ABC is \$60 - \$40 = \$20. XYZ's distributive share of the excess amount from ABC partnership is \$10. XYZ's deduction for business interest is limited to 30 percent of its adjusted taxable income plus its distributive share of the excess amount from ABC partnership (30 percent * \$0 + \$10 = \$10). As a result of the rule, XYZ may deduct \$10 of business interest and has an interest deduction disallowance of \$15.

Carryforward of disallowed business interest

The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward for up to five years. Carryforwards are determined on a first-in, first-out basis. It is intended that the provision be administered in a way to prevent trafficking in carryforwards.

A coordination rule is provided with the limitation on deduction of interest by domestic corporations in international financial reporting groups.³⁰ Whichever rule imposes the lower limitation on deduction of business interest with respect to the taxable year (and therefore the greatest amount of interest to be carried forward) governs.

Any carryforward of disallowed business interest is an item taken into account in the case of certain corporate acquisitions described in section 381 and is subject to limitation under section 382.

Exceptions

³⁰ See section 4302 of the bill (Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group).

The limitation does not apply to any taxpayer that meets the \$25 million gross receipts test of section 448(c), that is, if the average annual gross receipts for the three-taxable-year period ending with the prior taxable year does not exceed \$25 million.³¹ Aggregation rules apply to determine the amount of a taxpayer's gross receipts under the gross receipts test of section 448(c).

The trade or business of performing services as an employee is not treated as a trade or business for purposes of the limitation. As a result, for example, the wages of an employee are not counted in the adjusted taxable income of the taxpayer for purposes of determining the limitation.

The limitation does not apply to a real property trade or business as defined in section 469(c)(7)(C). Any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation.

The limitation does not apply to certain regulated public utilities. Specifically, the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State³² or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof is not treated as a trade or business for purposes of the limitation. As a result, for example, interest expense paid or incurred in a real property trade or business is not business interest subject to limitation and is generally deductible in the computation of taxable income.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

Senate Amendment

The Senate amendment is the same as the House bill, with the following modifications.

In general

The Senate amendment makes several changes to the definition of adjusted taxable income. Specifically, the Senate amendment does not add back deductions allowable for depreciation, amortization, or depletion, but does add back any deduction under section 199,³³

³¹ In the case of a sole proprietorship, the \$25 million gross receipts test is applied as if the sole proprietorship were a corporation or partnership.

³² The term “State” includes the District of Columbia. See sec. 7701(a)(10) (“The term ‘State’ shall be construed to include the District of Columbia where such construction is necessary to carry out provisions of this title”).

and any deduction under section 199A with respect to qualified business income of a passthrough entity.³⁴

The Senate amendment also modifies the definition of floor plan financing. Specifically, the Senate amendment permits interest on indebtedness used to finance acquisition of motor vehicles for sale or lease (i.e., not just for sale, as in the House bill) to qualify as floor plan financing interest. The Senate amendment also includes self-propelled vehicles in the definition of motor vehicle, but removes construction machinery and equipment from the definition.

Carryforward of disallowed business interest

The Senate amendment permits interest deductions to be carried forward indefinitely, subject to certain restrictions applicable to partnerships, described below.

Application to passthrough entities

The Senate amendment requires a partner in a partnership to ignore the partner's distributive share of all items of income, gain, deduction, or loss of the partnership when calculating adjusted taxable income (rather than merely ignoring the nonseparately stated income or loss, as in the House bill).

The Senate amendment takes a different mathematical approach from the House bill to calculating a partner's interest limitation, though both provisions have the same practical effect. In the Senate amendment, the limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess taxable income. The excess taxable income with respect to any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership, reduced by floor plan financing interest, exceeds the business interest income of the partnership bears to 30 percent of the adjusted taxable income of the partnership. This allows a partner of a partnership to deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. The Senate amendment requires that excess taxable income be allocated in the same manner as nonseparately stated income and loss. As in the House bill, rules similar to these rules also apply to S corporations.

The Senate amendment provides a special rule for carryforward of disallowed partnership interest. In the case of a partnership, the general carryforward rule described in the discussion of the House bill does not apply. Instead, any business interest that is not allowed as a deduction to the partnership for the taxable year is allocated to each partner in the same manner as nonseparately stated taxable income or loss of the partnership. The partner may deduct its share

³³ The deduction for income attributable to domestic production activities is repealed effective for taxable years beginning after December 31, 2018. *See* section 13305 of the Senate amendment (Repeal of reduction for income attributable to domestic production activities).

³⁴ *See* section 11011 of the Senate amendment (Deduction for qualified business income).

of the partnership's excess business interest in any future year, but only against excess taxable income attributed to the partner by the partnership the activities of which gave rise to the excess business interest carryforward. Any such deduction requires a corresponding reduction in excess taxable income. Additionally, when excess business interest is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of such allocation, even though the carryforward does not give rise to a partner deduction in the year of the basis reduction. However, the partner's deduction in a future year for interest carried forward does not reduce the partner's basis in the partnership interest. In the event the partner disposes of a partnership interest the basis of which has been so reduced, the partner's basis in such interest shall be increased, immediately before such disposition, by the amount that any such basis reductions exceed any amount of excess interest expense that has been treated as paid by the partner (*i.e.*, excess interest expense that has been deducted by the partner against excess taxable income of the same partnership). This special rule does not apply to S corporations and their shareholders.

Exceptions

The Senate amendment exempts certain categories of taxpayers or trades or businesses from the interest limitation. First, any taxpayer that meets the \$15 million gross receipts test of section 448(c) is exempt from the interest limitation.³⁵ Second, the Senate amendment expands the regulated public utilities exception in the House bill to include utilities where the rates for such furnishing or sale, as the case may be, have been established by the governing or ratemaking body of an electric cooperative.

In the Senate amendment, at the taxpayer's election, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses.³⁶ Similarly, at the taxpayer's election, any farming business,³⁷ as well as any

³⁵ See section 13102 of the Senate amendment (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships). In the case of a sole proprietorship, the \$15 million gross receipts test is applied as if the sole proprietorship were a corporation or partnership.

³⁶ It is intended that any such real property trade or business, including such a trade or business conducted by a corporation or real estate investment trust, be included. Because this description of a real property trade or business refers only to the section 469(c)(7)(C) description, and not to other rules of section 469 (such as the rule of section 469(c)(2) that passive activities include rental activities or the rule of section 469(a) that a passive activity loss is limited under section 469), the other rules of section 469 are not made applicable by this reference. It is further intended that a real property operation or a real property management trade or business includes the operation or management of a lodging facility.

³⁷ As defined in section 263A(e)(4) (*i.e.*, farming business means the trade or business of farming and includes the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots)). Treas. Reg. sec. 1.263A-4(a)(4) further defines a farming business as a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. Examples of a farming business include the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the

business engaged in the trade or business of a specified agricultural or horticultural cooperative, are not treated as trades or businesses for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses.

Conference Agreement

The conference agreement generally follows the Senate amendment, with the following modifications. Under the conference agreement, for taxable years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additionally, because the conference agreement repeals section 199 effective December 31, 2017, adjusted taxable income is computed without regard to such deduction. The conference agreement follows the House in exempting from the limitation taxpayers with average annual gross receipts for the three-taxable-year period ending with the prior taxable year that do not exceed \$25 million. In addition, for purposes of defining floor plan financing, the conference agreement modifies the definition of motor vehicle by deleting the specific references to an automobile, a truck, a recreational vehicle, and a motorcycle because those terms are encompassed in the phrase, “any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road,” which was also part of the definition in the Senate amendment.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

raising of ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals. A farming business also includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products. See Treas. Reg. sec. 1.263A-4(a)(4)(i) and (ii). A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another taxpayer, or merely buying and reselling plants or animals grown or raised by another taxpayer. See Treas. Reg. sec. 1.263A-4(a)(4)(i).

Code § 168. Accelerated cost recovery system

From House Ways and Means Committee Report, H. Rep. 115-409:

REASONS FOR CHANGE

The Committee believes that providing full expensing for certain business assets lowers the cost of capital for tangible property used in a trade or business. With lower costs of capital, the Committee believes that businesses will be encouraged to purchase equipment and other assets, which will promote capital investment and provide economic growth. The Committee also believes that full expensing for certain business assets will eliminate depreciation recordkeeping requirements for such assets.

From Conference Committee Report, H. Rep. 115-466:

Present Law

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.³⁸

Tangible property

Tangible property generally is depreciated under the modified accelerated cost recovery system (“MACRS”), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,³⁹ and convention.⁴⁰

Bonus depreciation

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service before January 1, 2020 (January 1, 2021, for longer production period property⁴¹ and certain aircraft⁴²).⁴³ The 50-

³⁸ See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer’s business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.*, section 280A.

³⁹ The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87-56, 1987-2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88-22, 1988-1 C.B. 785. In November 1988, Congress revoked the Secretary’s authority to modify the class lives of depreciable property. Rev. Proc. 87-56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

⁴⁰ Sec. 168.

percent allowance is phased down for property placed in service after December 31, 2017 (after December 31, 2018 for longer production period property and certain aircraft).

* * * * *

Qualified property

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements.⁴⁴ First, the property must be: (1) property to which MACRS applies with an applicable recovery period of 20 years or less; (2) water utility property;⁴⁵ (3) computer software other than computer software covered by section 197; or (4) qualified improvement property.⁴⁶ Second, the original use⁴⁷ of the property must commence with the taxpayer.⁴⁸ Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2020. As noted above, an extension of the placed-in-service date of one year (*i.e.*, before January 1, 2021) is provided for certain property with a recovery period of 10 years or longer, certain transportation property, and certain aircraft.⁴⁹

⁴¹ As defined in section 168(k)(2)(B).

⁴² As defined in section 168(k)(2)(C).

⁴³ Sec. 168(k). The additional first-year depreciation deduction is generally subject to the rules regarding whether a cost must be capitalized under section 263A.

⁴⁴ Requirements relating to actions taken before 2008 are not described herein since they have little (if any) remaining effect.

⁴⁵ As defined in section 168(e)(5).

⁴⁶ The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i).

⁴⁷ The term “original use” means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.*, each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)-1(b)(3).

⁴⁸ A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii) and (iii).

⁴⁹ Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding \$1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-in-service date, if at the time of the contract for purchase, the purchaser made a

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House Bill**Full expensing for certain business assets**

The provision extends and modifies the additional first-year depreciation deduction through 2022 (through 2023 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023.

* * * * *

Application to used property

The provision removes the requirement that the original use of qualified property must commence with the taxpayer. Thus, the provision applies to purchases of used as well as new items. To prevent abuses, the additional first-year depreciation deduction applies only to property purchased in an arm's-length transaction. It does not apply to property received as a gift or from a decedent.⁵⁰ In the case of trade-ins, like-kind exchanges, or involuntary conversions, it applies only to any money paid in addition to the traded-in property or in excess of the adjusted basis of the replaced property.⁵¹ It does not apply to property acquired in a nontaxable exchange such as a reorganization, to property acquired from a member of the taxpayer's family, including a spouse, ancestors, and lineal descendants, or from another related entity as defined in section 267, nor to property acquired from a person who controls, is controlled by, or is under common control with, the taxpayer.⁵² Thus it does not apply, for example, if one member of an affiliated group of corporations purchases property from another member, or if an individual who controls a corporation purchases property from that corporation.

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Senate Amendment**In general**

The provision extends and modifies the additional first-year depreciation deduction

nonrefundable deposit of the lesser of 10 percent of the cost or \$100,000, and which has an estimated production period exceeding four months and a cost exceeding \$200,000.

⁵⁰ By reference to section 179(d)(2)(C). See also Treas. Reg. sec. 1.179-4(c)(1)(iv).

⁵¹ By reference to section 179(d)(3). See also Treas. Reg. sec. 1.179-4(d).

⁵² By reference to section 179(d)(2)(A) and (B). See also Treas. Reg. sec. 1.179-4(c).

through 2026 (through 2027 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. Thus, the provision repeals the phase-down of the 50-percent allowance for property placed in service after December 31, 2017, and for specified plants planted or grafted after such date. The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft).

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Application to qualified film, television and live theatrical productions

The provision expands the definition of qualified property eligible for the additional first-year depreciation allowance to include qualified film, television and live theatrical productions⁴⁹⁵ placed in service after September 27, 2017, and before January 1, 2027, for which a deduction otherwise would have been allowable under section 181 without regard to the dollar limitation or termination of such section. For purposes of this provision, a production is considered placed in service at the time of initial release, broadcast, or live staged performance (*i.e.*, at the time of the first commercial exhibition, broadcast, or live staged performance of a production to an audience).

Exception for certain businesses not subject to limitation on interest expense

The provision excludes from the definition of qualified property any property which is primarily used in the trade or business of the furnishing⁵³ or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.⁵⁴

In addition, the provision excludes from the definition of qualified property any property used in a trade or business that has had floor plan financing indebtedness,⁵⁵ unless the taxpayer with such trade or business is not a tax shelter prohibited from using the cash method and is exempt from the interest limitation rules in section 13301 of the Senate amendment by meeting the small business gross receipts test of section 448(c).

* * * * *

⁵³ The term “furnishing” includes generation, transmission, and distribution activities.

⁵⁴ See sec. 13301 of the Senate amendment (Limitation on deduction for interest).

⁵⁵ As defined in section 13311 of the Senate amendment (Floor plan financing).

Conference Agreement

The conference agreement follows the Senate amendment but also includes the House bill's removal of the requirement that the original use of qualified property must commence with the taxpayer (*i.e.*, it allows the additional first-year depreciation deduction for new and used property).

In addition, the conference agreement also follows the House bill's application of the present-law phase-down of bonus depreciation to property acquired before September 28, 2017, and placed in service after September 27, 2017, as well as the present-law phase-down of the section 280F increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles acquired before September 28, 2017, and placed in service after September 27, 2017. * * * * *

As a conforming amendment to the repeal of corporate AMT, the conference agreement repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Effective date.—The provision generally applies to property acquired and placed in service after September 27, 2017, and to specified plants planted or grafted after such date. A transition rule provides that, for a taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect to apply a 50-percent allowance instead of the 100-percent allowance.

Code § 199A. Qualified business income

From Conference Committee Report, H. Rep. 115-466:

1. Deduction for qualified business income (sec. 1004 of the House bill, sec. 11011 of the Senate amendment, and sec. 199A of the Code)

Present Law

Individual income tax rates

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status (*i.e.*, single, head of household, married filing jointly, or married filing separately). For 2017, the regular individual income tax rate schedule provides rates of 10, 15, 25, 28, 33, 35, and 39.6 percent.

Partnerships

Partnerships generally are treated for Federal income tax purposes as pass-through

entities not subject to tax at the entity level.⁵⁶ Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account by the partners in computing their income tax liability (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).⁵⁷ A partner's deduction for partnership losses is limited to the partner's adjusted basis in its partnership interest.⁵⁸ Losses not allowed as a result of that limitation generally are carried forward to the next year. A partner's adjusted basis in the partnership interest generally equals the sum of (1) the partner's capital contributions to the partnership, (2) the partner's distributive share of partnership income, and (3) the partner's share of partnership liabilities, less (1) the partner's distributive share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any partnership distributions to the partner.⁵⁹ Partners generally may receive distributions of partnership property without recognition of gain or loss, subject to some exceptions.⁶⁰

Partnerships may allocate items of income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.⁶¹ In general, an allocation has substantial economic effect to the extent the partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation and the allocation substantially affects the dollar amounts to be received by the partners from the partnership independent of tax consequences.⁶²

State laws of every State provide for limited liability companies⁶³ ("LLCs"), which are neither partnerships nor corporations under applicable State law, but which are generally treated as partnerships for Federal tax purposes.⁶⁴

⁵⁶ Sec. 701.

⁵⁷ Sec. 702(a).

⁵⁸ Sec. 704(d). In addition, passive loss and at-risk limitations limit the extent to which certain types of income can be offset by partnership deductions (sections 469 and 465). These limitations do not apply to corporate partners (except certain closely-held corporations) and may not be important to individual partners who have partner-level passive income from other investments.

⁵⁹ Sec. 705.

⁶⁰ Sec. 731. Gain or loss may nevertheless be recognized, for example, on the distribution of money or marketable securities, distributions with respect to contributed property, or in the case of disproportionate distributions (which can result in ordinary income).

⁶¹ Sec. 704(b)(2).

⁶² Treas. Reg. sec. 1.704-1(b)(2).

⁶³ The first LLC statute was enacted in Wyoming in 1977. All States (and the District of Columbia) now have an LLC statute, though the tax treatment of LLCs for State tax purposes may differ.

⁶⁴ Under Treasury regulations promulgated in 1996, any domestic nonpublicly traded unincorporated entity with two or more members generally is treated as a partnership for federal income tax purposes, while any single-member domestic unincorporated entity generally is treated as disregarded for Federal income tax purposes (*i.e.*, treated as not separate from its owner). Instead of the applicable default

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.⁶⁵ For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).⁶⁶ An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.⁶⁷

S corporations

For Federal income tax purposes, an S corporation⁶⁸ generally is not subject to tax at the corporate level.⁶⁹ Items of income (including tax-exempt income), gain, loss, deduction, and credit of the S corporation are taken into account by the S corporation shareholders in computing their income tax liabilities (based on the S corporation's method of accounting and regardless of whether the income is distributed to the shareholders). A shareholder's deduction for corporate losses is limited to the sum of the shareholder's adjusted basis in its S corporation stock and the indebtedness of the S corporation to such shareholder. Losses not allowed as a result of that limitation generally are carried forward to the next year. A shareholder's adjusted basis in the S corporation stock generally equals the sum of (1) the shareholder's capital contributions to the S corporation and (2) the shareholder's pro rata share of S corporation income, less (1) the shareholder's pro rata share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any S corporation distributions to the shareholder.⁷⁰

treatment, however, an LLC may elect to be treated as a corporation for Federal income tax purposes. Treas. Reg. sec. 301.7701-3. These are known as the "check-the-box" regulations.

⁶⁵ Sec. 7704(a).

⁶⁶ Sec. 7704(b).

⁶⁷ Sec. 7704(c)(2). Qualifying income is defined to include interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Sec. 7704(d). Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of certain fuel mixtures, alternative fuel, alcohol fuel, or biodiesel fuel. It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) where a principal activity of the partnership is the buying and selling of such commodities, futures, options, or forward contracts. However, the exception for partnerships with qualifying income does not apply to any partnership resembling a mutual fund (*i.e.*, that would be described in section 851(a) if it were a domestic corporation), which includes a corporation registered under the Investment Company Act of 1940 (Pub. L. No. 76-768 (1940)) as a management company or unit investment trust (sec. 7704(c)(3)).

⁶⁸ An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

⁶⁹ Secs. 1363 and 1366.

⁷⁰ Sec. 1367. If any amount that would reduce the adjusted basis of a shareholder's S corporation stock exceeds the amount that would reduce that basis to zero, the excess is applied to reduce (but not below

In general, an S corporation shareholder is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation.

Electing S corporation status

To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.⁷¹ Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders of an S corporation.

Sole proprietorships

Unlike a C corporation, partnership, or S corporation, a business conducted as a sole proprietorship is not treated as an entity distinct from its owner for Federal income tax purposes.⁷² Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return. Furthermore, transfer of a sole proprietorship is treated as a transfer of each individual asset of the business. Nonetheless, a sole proprietorship is treated as an entity separate from its owner for employment tax purposes,⁷³ for certain excise taxes,⁷⁴ and certain information reporting requirements.⁷⁵

House Bill

Qualified business income of an individual from a partnership, S corporation, or sole proprietorship is subject to Federal income tax at a rate no higher than 25 percent. Qualified business income means, generally, all net business income from a passive business activity plus the capital percentage of net business income from an active business activity, reduced by carryover business losses and by certain net business losses from the current year, as determined

zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. If, after a reduction in the basis of such indebtedness, there is an event that would increase the adjusted basis of the shareholder's S corporation stock, such increase is instead first applied to restore the reduction in the basis of the shareholder's indebtedness.

Sec. 1367(b)(2).

⁷¹ Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

⁷² A single-member unincorporated entity is disregarded for Federal income tax purposes, unless its owner elects to be treated as a C corporation. Treas. Reg. sec. 301.7701-3(b)(1)(ii). Sole proprietorships often are conducted through legal entities for nontax reasons. While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).

⁷³ Treas. Reg. sec. 301.7701-2(c)(2)(iv).

⁷⁴ Treas. Reg. sec. 301.7701-2(c)(2)(v).

⁷⁵ Treas. Reg. sec. 301.7701-2(c)(2)(vi).

under the provision.

* * * * *

Senate Amendment

In general

For taxable years beginning after December 31, 2017 and before January 1, 2026, an individual taxpayer generally may deduct 23 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 23 percent of aggregate qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Special rules apply to specified agricultural or horticultural cooperatives. A limitation based on W-2 wages paid is phased in above a threshold amount of taxable income. A disallowance of the deduction with respect to specified service trades or businesses is also phased in above the threshold amount of taxable income.⁷⁶

Qualified business income

Qualified business income is determined for each qualified trade or business of the taxpayer. For any taxable year, qualified business income means the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. The determination of qualified items of income, gain, deduction, and loss takes into account these items only to the extent included or allowed in the determination of taxable income for the year. For example, if in a taxable year, a qualified business has \$100,000 of ordinary income from inventory sales, and makes an expenditure of \$25,000 that is required to be capitalized and amortized over 5 years under applicable tax rules, the qualified business income is \$100,000 minus \$5,000 (current-year ordinary amortization deduction), or \$95,000. The qualified business income is not reduced by the entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward as a loss from a qualified trade or business in the next taxable year. Similar to a qualified trade or business that has a qualified business loss for the current taxable year, any deduction allowed in a subsequent year is reduced (but not below zero) by 23 percent of any carryover qualified business loss. For example, Taxpayer has qualified business income of \$20,000 from qualified business A and a qualified business loss of \$50,000 from qualified business B in Year 1. Taxpayer is not permitted a deduction for Year 1 and has a carryover qualified business loss of \$30,000 to Year 2. In Year 2, Taxpayer has qualified business income of \$20,000 from qualified business A and qualified business income of \$50,000 from qualified business B. To determine the deduction for Year 2, Taxpayer reduces the 23 percent deductible amount determined for the qualified business income of \$70,000 from qualified businesses A and B by 23 percent of the \$30,000 carryover qualified business loss.

⁷⁶ For purposes of this provision, taxable income is computed without regard to the 23 percent deduction.

Domestic business

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States.⁷⁷

* * * * *

Treatment of investment income

Qualified items do not include specified investment-related income, deductions, or loss. Specifically, qualified items of income, gain, deduction and loss do not include (1) any item taken into account in determining net long-term capital gain or net long-term capital loss, (2) dividends, income equivalent to a dividend, or payments in lieu of dividends, (3) interest income other than that which is properly allocable to a trade or business, (4) the excess of gain over loss from commodities transactions, other than those entered into in the normal course of the trade or business or with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business, (5) the excess of foreign currency gains over foreign currency losses from section 988 transactions, other than transactions directly related to the business needs of the business activity, (6) net income from notional principal contracts, other than clearly identified hedging transactions that are treated as ordinary (i.e., not treated as capital assets), and (7) any amount received from an annuity that is not used in the trade or business of the business activity. Qualified items under this provision do not include any item of deduction or loss properly allocable to such income.

Reasonable compensation and guaranteed payments

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business,⁷⁸ and to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services.⁷⁹

Qualified trade or business

A qualified trade or business means any trade or business other than a specified service trade or business and other than the trade or business of being an employee.

Specified service business

⁷⁷ For this purpose, section 864(c) is applied substituting “qualified trade or business (within the meaning of section 199A)” for “nonresident alien individual or a foreign corporation” or “a foreign corporation.”

⁷⁸ Described in sec. 707(c).

⁷⁹ Described in sec. 707(a).

A specified service trade or business means any trade or business involving the performance of services in the fields of health,⁸⁰ law, engineering, architecture, accounting, actuarial science, performing arts,⁸¹ consulting,⁸² athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. For this purpose a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (sections 475(c)(2) and 475(e)(2), respectively).

Phase-in of specified service business limitation

The exclusion from the definition of a qualified business for specified service trades or businesses phases in for a taxpayer with taxable income in excess of a threshold amount. The threshold amount is \$250,000 (200 percent of that amount, or \$500,000, in the case of a joint return) (the “threshold amount”). The threshold amount is indexed for inflation. The exclusion from the definition of a qualified business for specified service trades or businesses is fully phased in for a taxpayer with taxable income in excess of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return). For a taxpayer with taxable income within the phase-in

⁸⁰ A similar list of service trades or business is provided in section 448(d)(2)(A) and Treas. Reg. sec. 1.448-1T(e)(4)(i). For purposes of section 448, Treasury regulations provide that the performance of services in the field of health means the provision of medical services by physicians, nurses, dentists, and other similar healthcare professionals. The performance of services in the field of health does not include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers. See Treas. Reg. sec. 1.448-1T(e)(4)(ii).

⁸¹ For purposes of the similar list of services in section 448, Treasury regulations provide that the performance of services in the field of the performing arts means the provision of services by actors, actresses, singers, musicians, entertainers, and similar artists in their capacity as such. The performance of services in the field of the performing arts does not include the provision of services by persons who themselves are not performing artists (*e.g.*, persons who may manage or promote such artists, and other persons in a trade or business that relates to the performing arts). Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate the performance of such artists to members of the public (*e.g.*, employees of a radio station that broadcasts the performances of musicians and singers). See Treas. Reg. sec. 1.448-1T(e)(4)(iii).

⁸² For purposes of the similar list of services in section 448, Treasury regulations provide that the performance of services in the field of consulting means the provision of advice and counsel. The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales or brokerage services, or economically similar services. For purposes of the preceding sentence, the determination of whether a person’s services are sales or brokerage services, or economically similar services, shall be based on all the facts and circumstances of that person’s business. Such facts and circumstances include, for example, the manner in which the taxpayer is compensated for the services provided (*e.g.*, whether the compensation for the services is contingent upon the consummation of the transaction that the services were intended to effect). See Treas. Reg. sec. 1.448-1T(e)(4)(iv).

range, the exclusion applies as follows.

In computing the qualified business income with respect to a specified service trade or business, the taxpayer takes into account only the applicable percentage of qualified items of income, gain, deduction, or loss, and of allocable W-2 wages. The applicable percentage with respect to any taxable year is 100 percent reduced by the percentage equal to the ratio of the excess of the taxable income of the taxpayer over the threshold amount bears to \$50,000 (\$100,000 in the case of a joint return).

For example, Taxpayer has taxable income of \$280,000, of which \$200,000 is attributable to an accounting sole proprietorship after paying wages of \$100,000 to employees. Taxpayer has an applicable percentage of 40 percent.⁸³ In determining includible qualified business income, Taxpayer takes into account 40 percent of \$200,000, or \$80,000. In determining the includible W-2 wages, Taxpayer takes into account 40 percent of \$100,000, or \$40,000. Taxpayer calculates the deduction by taking the lesser of 23 percent of \$80,000 (\$18,400) or 50 percent of \$40,000 (\$20,000). Taxpayer takes a deduction for \$18,400.

Tentative deductible amount for a qualified trade or business

In general

For each qualified trade or business, the taxpayer is allowed a deductible amount equal to the lesser of 23 percent of the qualified business income with respect to such trade or business or 50 percent of the W-2 wages with respect to such business (the “wage limit”). However, if the taxpayer’s taxable income is below the threshold amount, the deductible amount for each qualified trade or business is equal to 23 percent of the qualified business income with respect to each respective trade or business.

W-2 wages

W-2 wages are the total wages⁸⁴ subject to wage withholding, elective deferrals,⁸⁵ and deferred compensation⁸⁶ paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the taxable year of the taxpayer.⁸⁷ W-2 wages

⁸³ $1 - (\$280,000 - \$250,000)/\$50,000 = 1 - 30,000/50,000 = 1 - .6 = 40$ percent.

⁸⁴ Defined in sec. 3401(a).

⁸⁵ Within the meaning of sec. 402(g)(3).

⁸⁶ Deferred compensation includes compensation deferred under section 457, as well as the amount of any designated Roth contributions (as defined in section 402A).

⁸⁷ In the case of a taxpayer with a short taxable year that does not contain a calendar year ending during such short taxable year, the Committee intends that the following amounts shall be treated as the W-2 wages of the taxpayer for the short taxable year: (1) only those wages paid during the short taxable year to employees of the qualified trade or business, (2) only those elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the qualified trade or business, and (3) only compensation actually deferred under section 457 during the short taxable year with respect to

do not include any amount which is not properly allocable to the qualified business income as a qualified item of deduction. In addition, W-2 wages do not include any amount which was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

* * * * *

Phase-in of wage limit

The application of the wage limit phases in for a taxpayer with taxable income in excess of the threshold amount. The wage limit applies fully for a taxpayer with taxable income in excess of the threshold amount plus \$50,000 (\$100,000 in the case of a joint return). For a taxpayer with taxable income within the phase-in range, the wage limit applies as follows.

With respect to any qualified trade or business, the taxpayer compares (1) 23 percent of the taxpayer's qualified business income with respect to the qualified trade or business with (2) 50 percent of the W-2 wages with respect to the qualified trade or business. If the amount determined under (2) is less than the amount determined (1), (that is, if the wage limit is binding), the taxpayer's deductible amount is the amount determined under (1) reduced by the same proportion of the difference between the two amounts as the excess of the taxable income of the taxpayer over the threshold amount bears to \$50,000 (\$100,000 in the case of a joint return).

For example, H and W file a joint return on which they report taxable income of \$520,000. W has a qualified trade or business that is not a specified service business, such that 23 percent of the qualified business income with respect to the business is \$15,000. W's share of wages paid by the business is \$20,000, such that 50 percent of the W-2 wages with respect to the business is \$10,000. The \$15,000 amount is reduced by 20 percent⁸⁸ of the difference between \$15,000 and \$10,000, or \$1,000. H and W take a deduction for \$14,000.

Qualified REIT dividends, cooperative dividends, and publicly traded partnership income

A deduction is allowed under the provision for 23 percent of the taxpayer's aggregate amount of qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income for the taxable year. * * * * * Qualified publicly traded partnership income means (with respect to any qualified trade or business of the taxpayer), the sum of the (a) the net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss (that are effectively connected with a U.S. trade or business and are included or allowed in determining taxable income for the taxable year and do not constitute excepted enumerated investment-type income, and not including the taxpayer's reasonable compensation, guaranteed payments for services, or (to the extent provided in regulations) section 707(a) payments for services) from a publicly traded partnership not treated as a corporation, and (b)

employees of the qualified trade or business. The Committee intends that amounts that are treated as W-2 wages for a taxable year shall not be treated as W-2 wages of any other taxable year.

⁸⁸ $(\$520,000 - \$500,000) / \$100,000 = 20$ percent.

gain recognized by the taxpayer on disposition of its interest in the partnership that is treated as ordinary income (for example, by reason of section 751).

Determination of the taxpayer's deduction

The taxpayer's deduction for qualified business income is equal to the lesser of the combined qualified business income amount for the taxable year or an amount equal to 23 percent of the taxpayer's taxable income (reduced by any net capital gain⁶⁰) for the taxable year. The combined qualified business income amount is the sum of the deductible amounts determined for each qualified trade or business for the taxable year and 23 percent of the qualified REIT dividends and qualified cooperative dividends received by the taxpayer for the taxable year.

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Special rules and definitions

For purposes of the provision, taxable income is determined without regard to the deduction allowable under the provision.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner takes into account the partner's allocable share of each qualified item of income, gain, deduction, and loss, and is treated as having W-2 wages for the taxable year equal to the partner's allocable share of W-2 wages of the partnership. The partner's allocable share of W-2 wages is required to be determined in the same manner as the partner's share of wage expenses. For example, if a partner is allocated a deductible amount of 10 percent of wages paid by the partnership to employees for the taxable year, the partner is required to be allocated 10 percent of the W-2 wages of the partnership for purposes of calculating the wage limit under this deduction. Similarly, each shareholder of an S corporation takes into account the shareholder's pro rata share of each qualified item of income, gain, deduction, and loss, and is treated as having W-2 wages for the taxable year equal to the shareholder's pro rata share of W-2 wages of the S corporation.

Qualified business income is determined without regard to any adjustments prescribed under the rules of the alternative minimum tax.

The provision does not apply to a trust or estate.

The deduction under the provision is allowed only for Federal income tax purposes.

For purposes of determining a substantial underpayment of income tax under the accuracy related penalty,⁸⁹ a substantial underpayment exists if the amount of the understatement exceeds the greater of five percent (not 10 percent) of the tax required to be shown on the return or \$5,000.

⁸⁹ Sec. 6662(d)(1)(A).

Authority is provided to promulgate regulations needed to carry out the purposes of the provision, including regulations requiring, or restricting, the allocation of items of income, gain, loss, or deduction, or of wages under the provision. In addition, regulatory authority is provided to address reporting requirements appropriate under the provision, and the application of the provision in the case of tiered entities.

The provision does not apply to taxable years beginning after December 31, 2025.

Additional examples

The following examples provide a comprehensive illustration of the provision.

Example 1

H and W file a joint return on which they report taxable income of \$520,000 (determined without regard to this provision). H is a partner in a qualified trade or business that is not a specified service business (“qualified business A”). W has a sole proprietorship qualified trade or business that is a specified service business (“qualified business B”). H and W also received \$10,000 in qualified REIT dividends during the tax year.

H’s allocable share of qualified business income from qualified business A is \$300,000, such that 23 percent of the qualified business income with respect to the business is \$69,000.⁹⁰ H’s allocable share of wages paid by qualified business A is \$100,000, such that 50 percent of the W-2 wages with respect to the business is \$50,000.⁹¹ As H and W’s taxable income is above the threshold amount for a joint return, the application of the wage limit for qualified business A is phased in. Accordingly, the \$69,000 amount is reduced by 20 percent⁹² of the difference between \$69,000 and \$50,000, or \$3,800.⁹³ H’s deductible amount for qualified business A is \$65,200.⁹⁴

W’s qualified business income and W-2 wages from qualified business B, which is a specified service business, are \$325,000 and \$150,000, respectively. H and W’s taxable income is above the threshold amount for a joint return. Thus, the exclusion of qualified business income and W-2 wages from the specified service business are phased in. W has an applicable percentage of 80 percent.⁹⁵ In determining includible qualified business income, W takes into account 80 percent of \$325,000, or \$260,000. In determining includible W-2 wages, W takes into account 80 percent of \$150,000, or \$120,000. W calculates the deductible amount for qualified business B by taking the lesser of 23 percent of \$260,000 (\$59,800) or 50 percent of

⁹⁰ $\$300,000 * .23 = \$69,000$.

⁹¹ $\$100,000 * .5 = \$50,000$.

⁹² $(\$520,000 - \$500,000) / \$100,000 = 20$ percent.

⁹³ $(\$69,000 - \$50,000) * .2 = \$3,800$.

⁹⁴ $\$69,000 - \$3,800 = \$65,200$.

⁹⁵ $1 - (\$520,000 - \$500,000) / \$100,000 = 1 - \$20,000 / \$100,000 = 1 - .2 = 80$ percent.

includible W-2 wages of \$120,000 (\$60,000).⁹⁶ W's deductible amount for qualified business B is \$59,800.

H and W's combined qualified business income amount of \$127,300 is comprised of the deductible amount for qualified business A of \$65,200, the deductible amount for qualified business B of \$59,800, and 23 percent of the \$10,000 qualified REIT dividends (\$2,300). H and W's deduction is limited to 23 percent of their taxable income for the year (\$520,000), or \$119,600. Accordingly, H and W's deduction for the taxable year is \$119,600.

Example 2

H and W file a joint return on which they report taxable income of \$200,000 (determined without regard to this provision). H has a sole proprietorship qualified trade or business that is not a specified service business ("qualified business A"). W is a partner in a qualified trade or business that is not a specified service business ("qualified business B"). H and W have a carryover qualified business loss of \$50,000.

H's qualified business income from qualified business A is \$150,000, such that 23 percent of the qualified business income with respect to the business is \$34,500. As H and W's taxable income is below the threshold amount for a joint return, the wage limit does not apply to qualified business A. H's deductible amount for qualified business A is \$34,500.

W's allocable share of qualified business loss is \$40,000, such that 23 percent of the qualified business loss with respect to the business is \$9,200. As H and W's taxable income is below the threshold amount for a joint return, the wage limit does not apply to qualified business B. W's deductible amount for qualified business B is a reduction to the deduction of \$9,200.

H and W's combined qualified business income amount of \$13,800 is comprised of the deductible amount for qualified business A of \$34,500, the reduction to the deduction for qualified business B of \$9,200, and the reduction to the deduction of \$11,500 attributable to the carryover qualified business loss. H and W's deduction is limited to 23 percent of their taxable income for the year (\$200,000), or \$46,000. Accordingly, H and W's deduction for the taxable year is \$13,800.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

Conference Agreement

The conference agreement follows the Senate amendment with modifications.

Deduction percentage

⁹⁶ Although H and W's taxable income is above the threshold amount for a joint return, the wage limit is not binding as the 23 percent of includible qualified business income of qualified business B (\$59,800) is less than 50 percent of includible W-2 wages of qualified business B (\$60,000).

Under the conference agreement, the percentage of the deduction allowable under the provision is 20 percent (not 23 percent).

Threshold amount

The conference agreement reduces the threshold amount above which both the limitation on specified service businesses and the wage limit are phased in. Under the conference agreement, the threshold amount is \$157,500 (twice that amount or \$315,000 in the case of a joint return), indexed. The conferees expect that the reduced threshold amount will serve to deter high-income taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20-percent deduction under the provision. The conference agreement provides that the range over which the phase-in of these limitations applies is \$50,000 (\$100,000 in the case of a joint return).

Limitation based on W-2 wages and capital

The conference agreement modifies the wage limit applicable to taxpayers with taxable income above the threshold amount to provide a limit based either on wages paid or on wages paid plus a capital element. Under the conference agreement, the limitation is the greater of (a) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.

For purposes of the provision, qualified property means tangible property of a character subject to depreciation that is held by, and available for use in, the qualified trade or business at the close of the taxable year, and which is used in the production of qualified business income, and for which the depreciable period has not ended before the close of the taxable year. The depreciable period with respect to qualified property of a taxpayer means the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (a) the date 10 years after that date, or (b) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (without regard to section 168(g)).

For example, a taxpayer (who is subject to the limit) does business as a sole proprietorship conducting a widget-making business. The business buys a widget-making machine for \$100,000 and places it in service in 2020. The business has no employees in 2020. The limitation in 2020 is the greater of (a) 50 percent of W-2 wages, or \$0, or (b) the sum of 25 percent of W-2 wages (\$0) plus 2.5 percent of the unadjusted basis of the machine immediately after its acquisition: $\$100,000 \times .025 = \$2,500$. The amount of the limitation on the taxpayer's deduction is \$2,500.

In the case of property that is sold, for example, the property is no longer available for use in the trade or business and is not taken into account in determining the limitation. The Secretary is required to provide rules for applying the limitation in cases of a short taxable year of where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the year. The Secretary is required

to provide guidance applying rules similar to the rules of section 179(d)(2) to address acquisitions of property from a related party, as well as in a sale-leaseback or other transaction as needed to carry out the purposes of the provision and to provide anti-abuse rules, including under the limitation based on W-2 wages and capital. Similarly, the Secretary shall provide guidance prescribing rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions as needed to carry out the purposes of the provision and to provide anti-abuse rules, including under the limitation based on W-2 wages and capital.

Specified service trade or business

The conference agreement modifies the definition of a specified service trade or business in several respects. The definition is modified to exclude engineering and architecture services, and to take into account the reputation or skill of owners.

A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. For this purpose a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (sections 475(c)(2) and 475(e)(2), respectively).

Determination of the taxpayer's deduction

The taxpayer's deduction for qualified business income for the taxable year is equal to the sum of (a) the lesser of the combined qualified business income amount for the taxable year or an amount equal to 20 percent of the excess of taxpayer's taxable income over any net capital gain⁹⁷ and qualified cooperative dividends, plus (b) the lesser of 20 percent of qualified cooperative dividends and taxable income (reduced by net capital gain). This sum may not exceed the taxpayer's taxable income for the taxable year (reduced by net capital gain). Under the provision, the 20-percent deduction with respect to qualified cooperative dividends is limited to taxable income (reduced by net capital gain) for the year. The combined qualified business income amount for the taxable year is the sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer and 20 percent of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. The deductible amount for each qualified trade or business is the lesser of (a) 20 percent of the taxpayer's qualified business income with respect to the trade or business, or (b) the greater of 50 percent of the W-2 wages with respect to the trade or business or the sum of 25 percent of the W-2 wages with respect to the trade or business and 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.

Deduction against taxable income

⁹⁷ Defined in sec. 1(h).

The conference agreement clarifies that the 20-percent deduction is not allowed in computing adjusted gross income, and instead is allowed as a deduction reducing taxable income. Thus, for example, the provision does not affect limitations based on adjusted gross income. Similarly the conference agreement clarifies that the deduction is available to both nonitemizers and itemizers.

* * * * *

Treatment of trusts and estates

The conference agreement provides that trusts and estates are eligible for the 20-percent deduction under the provision. Rules similar to the rules under present-law section 199 (as in effect on December 1, 2017) apply for apportioning between fiduciaries and beneficiaries any W-2 wages and unadjusted basis of qualified property under the limitation based on W-2 wages and capital.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

Code § 481. Adjustments required by changes in method of accounting
Code § 1371. Coordination with subchapter C

From House Ways and Means Committee Report, H. Rep. 115-409:

REASONS FOR CHANGE

The Committee recognizes that, with the significant modifications to the tax code with respect to both S corporations and C corporations in this bill, taxpayers that previously elected to be taxed as S corporations may prefer instead to be taxed as C corporations. The Committee acknowledges that the revocation of an S election may require certain taxpayers to change from the cash method to an accrual method, and may have other effects on the taxpayer. Accordingly, the Committee believes that it is important to provide rules to ease the transition from S corporation to C corporation for the affected taxpayers.

From Conference Committee Report, H. Rep. 115-466:

3. Modification of treatment of S corporation conversions to C corporations (sec. 3204 of the House bill, sec. 13543 of the Senate amendment, and secs. 481 and 1371 of the Code)

Present Law

Changes in accounting method

Cash and accrual methods in general

Taxpayers using the cash method generally recognize items of income when actually or constructively received and items of expense when paid. The cash method is administratively easy and provides the taxpayer flexibility in the timing of income recognition. It is the method generally used by most individual taxpayers, including farm and nonfarm sole proprietorships.

Taxpayers using an accrual method generally accrue items of income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.⁹⁸ Taxpayers using an accrual method of accounting generally may not deduct items of expense prior to when all events have occurred that fix the obligation to pay the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred.⁹⁹ Accrual methods of accounting generally result in a more accurate measure of economic income than does the cash method. The accrual method is often used by businesses for financial accounting purposes.

A C corporation, a partnership that has a C corporation as a partner, or a tax-exempt trust or corporation with unrelated business income generally may not use the cash method.

⁹⁸ See, e.g., sec. 451.

⁹⁹ See, e.g., sec. 461.

Exceptions are made for farming businesses,¹⁰⁰ qualified personal service corporations,¹⁰¹ and the aforementioned entities to the extent their average annual gross receipts do not exceed \$5 million for all prior years (including the prior taxable years of any predecessor of the entity) (the “gross receipts test”).¹⁰² The cash method may not be used by any tax shelter.¹⁰³ In addition, the cash method generally may not be used if the purchase, production, or sale of merchandise is an income producing factor.¹⁰⁴ Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.¹⁰⁵

Procedures for changing a method of accounting

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.¹⁰⁶ Except as otherwise provided, section 446(e) requires taxpayers to secure consent of the Secretary before changing a method of accounting. The regulations under this section provide rules for determining: (1) what a method of accounting is, (2) how an adoption of a method of accounting occurs, and (3) how a change in method of accounting is effectuated.¹⁰⁷

¹⁰⁰ A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees. Sec. 448(d)(1).

¹⁰¹ A qualified personal service corporation is a corporation (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates, or heirs. Sec. 448(d)(2).

¹⁰² The gross receipts test is modified to apply to taxpayers with annual average gross receipts that do not exceed \$25 million for the three prior taxable-year period as part of this bill. See section 3202 of the bill (Small business accounting method reform and simplification).

¹⁰³ Secs. 448(a)(3) and (d)(3) and 461(i)(3) and (4). For this purpose, a tax shelter includes: (1) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale; (2) any syndicate (within the meaning of section 1256(e)(3)(B)); or (3) any tax shelter as defined in section 6662(d)(2)(C)(ii). In the case of a farming trade or business, a tax shelter includes any tax shelter as defined in section 6662(d)(2)(C)(ii) or any partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, (1) if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale or (2) if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

¹⁰⁴ Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1.

¹⁰⁵ Sec. 471 and Treas. Reg. secs. 1.446-1(c)(2) and 1.471-1. However, section 3202 of the House bill (Small business accounting method reform and simplification) provides an exemption from the requirement to use inventories for taxpayers that meet the \$25 million gross receipts test provided in such section. Accordingly, under the bill, such taxpayers are thus also eligible to use the cash method.

¹⁰⁶ Treas. Reg. sec. 1.446-1(e)(1).

¹⁰⁷ Treas. Reg. sec. 1.446-1(e).

Section 481 prescribes the rules to be followed in computing taxable income in cases where the taxable income of the taxpayer is computed under a different method than the prior year (*e.g.*, when changing from the cash method to an accrual method). In computing taxable income for the year of change, the taxpayer must take into account those adjustments which are determined to be necessary solely by reason of such change in order to prevent items of income or expense from being duplicated or omitted.¹⁰⁸ The year of change is the taxable year for which the taxable income of the taxpayer is computed under a different method than the prior year.¹⁰⁹ Congress has provided the Secretary with the authority to prescribe the timing and manner in which such adjustments are taken into account in computing taxable income.¹¹⁰ Net adjustments that decrease taxable income generally are taken into account entirely in the year of change, and net adjustments that increase taxable income generally are taken into account ratably during the four-taxable-year period beginning with the year of change.¹¹¹

Post-termination distributions

Under present law, in the case of an S corporation that converts to a C corporation, distributions of cash by the C corporation to its shareholders during the post-termination transition period (to the extent of the amount in the accumulated adjustment account) are tax-free to the shareholders and reduce the adjusted basis of the stock.¹¹² The post-termination transition period is generally the one-year period after the S corporation election terminates.¹¹³

House Bill

Under the provision, any section 481(a) adjustment of an eligible terminated S corporation attributable to the revocation of its S corporation election (*i.e.*, a change from the cash method to an accrual method) is taken into account ratably during the six-taxable-year period beginning with the year of change.¹¹⁴ An eligible terminated S corporation is any C corporation which (1) is an S corporation the day before the enactment of this bill, (2) during the

¹⁰⁸ Sec. 481(a)(2) and Treas. Reg. sec. 1.481-1(a)(1).

¹⁰⁹ Treas. Reg. sec. 1.481-1(a)(1).

¹¹⁰ Sec. 481(c). While Treasury regulations generally provide that the entire adjustments required by section 481(a) are taken into account entirely in the year of change, the Secretary has provided the Commissioner with the authority to provide additional guidance regarding the taxable year or years in which the adjustments are taken into account. See Treas. Reg. sec. 1.481-1(c)(2).

¹¹¹ See Section 7.03 of Rev. Proc. 2015-13, 2015-5 I.R.B. 419.

¹¹² Sec. 1371(e)(1).

¹¹³ Sec. 1377(b).

¹¹⁴ Section 3202 of the House bill (Small business accounting method reform and simplification) expand the universe of partnerships and C corporations eligible to use the cash method to include partnerships or C corporations with annual average gross receipts that do not exceed \$25 million for the three prior taxable-year period. Accordingly, an eligible terminated S corporation with annual average gross receipts that do not exceed \$25 million that used the cash method prior to revoking its S corporation election may be eligible to remain on the cash method as a C corporation.

two-year period beginning on the date of such enactment revokes its S corporation election under section 1362(a), and (3) all of the owners of which on the date the S corporation election is revoked are the same owners (and in identical proportions) as the owners on the date of such enactment.

Under the provision, in the case of a distribution of money by an eligible terminated S corporation, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of the accumulated adjustments account bears to the amount the accumulated earnings and profits.

Effective date.—The provision is effective upon enactment.

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Conference Agreement

The conference agreement follows the House bill.

Code § 1361. S corporation defined

From Conference Committee Report, H. Rep. 115-466:

5. Expansion of qualifying beneficiaries of an electing small business trust (sec. 13541 of the Senate amendment and sec. 1361 of the Code)

Present Law

An electing small business trust (“ESBT”) may be a shareholder of an S corporation.¹¹⁵ Generally, the eligible beneficiaries of an ESBT include individuals, estates, and certain charitable organizations eligible to hold S corporation stock directly. A nonresident alien individual may not be a shareholder of an S corporation and may not be a potential current beneficiary of an ESBT.¹¹⁶

The portion of an ESBT which consists of the stock of an S corporation is treated as a separate trust and generally is taxed on its share of the S corporation’s income at the highest rate of tax imposed on individual taxpayers. This income (whether or not distributed by the ESBT) is not taxed to the beneficiaries of the ESBT.

¹¹⁵ Sec. 1361(c)(2)(A)(v).

¹¹⁶ Sec. 1361(b)(1)(C) and (c)(2)(B)(v).

House Bill

No provision.

Senate Amendment

The Senate amendment allows a nonresident alien individual to be a potential current beneficiary of an ESBT.

Effective date.—The provision takes effect on January 1, 2018.

Conference Agreement

The conference agreement follows the Senate amendment.