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TAX PLANNING LETTER
DECEMBER 2017, #243

Highlights of the "Tax Cuts and Jobs Act" (Business Tax Changes)

On 12/22/17, President Trump signed into law H.R. 1, the "Tax Cuts and Jobs Act," a sweeping tax reform law that will entirely change the tax landscape. The legislation reflects the largest major tax reform in over three decades.

This **Tax Planning Letter**, which refers to the Act by its commonly used name, "Tax Cuts and Jobs Act" (or simply, the "Act") describes key **business tax changes** that are made under the Act. Among the changes are a permanent reduction in the corporate tax rate to 21%, repeal of the corporate alternative minimum tax (AMT), imposition of new limits on business interest deductions, and a number of changes involving expensing and depreciation.

For comprehensive summaries on other areas of the new law, see:

(#244) Highlights of the "Tax Cuts and Jobs Act" - Individual Tax Changes
(#245) Highlights of the "Tax Cuts and Jobs Act" - S Corporations, Partnerships and Other Changes

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TAX RATES

Corporate Tax Rates Reduced

PRE-ACT LAW: Corporations are subject to graduated tax rates of 15% (for taxable income of $0-$50,000), 25% (for taxable income of $50,001-$75,000), 34% (for taxable income of $75,001-$10,000,000), and 35% (for taxable income over $10,000,000). Personal service corporations pay tax on their entire taxable income at the rate of 35%.

NEW LAW: For tax years beginning after 12/31/17, the corporate tax rate is a flat 21% rate.

Dividends-Received Deduction Percentages Reduced

PRE-ACT LAW: Corporations that receive dividends from other corporations are entitled to a deduction for dividends received. If the corporation owns at least 20% of the stock of another corporation, an 80% dividends received deduction is allowed. Otherwise, a 70% deduction is allowed.
NEW LAW: For tax years beginning after 12/31/17, the 80%

dividends received deduction is reduced to 65%, and the 70% dividends received deduction is reduced to 50%.

Alternative Minimum Tax (AMT) Repealed

PRE-ACT LAW: The corporate AMT is 20%, with an exemption amount of up to $40,000. Corporations with average gross receipts of less than $7.5 million for the preceding three tax years are exempt from the AMT. The exemption amount phases out starting at $150,000 of alternative minimum taxable income.

NEW LAW: For tax years beginning after 12/31/17, the corporate AMT is repealed.

For tax years beginning after 2017 and before 2022, the AMT credit is refundable and can offset regular tax liability in an amount equal to 50% (100% for tax years beginning in 2021) of the excess of the minimum tax credit for the tax year over the amount of the credit allowable for the year against regular tax liability. Accordingly, the full amount of the minimum tax credit will be allowed in tax years beginning before 2022.

EXPENSING & DEPRECIATION

Increased §179 Expensing

A taxpayer may, subject to limitations, elect under §179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions.

PRE-ACT LAW: The maximum amount a taxpayer could expense was $500,000 of the cost of "qualifying property" placed in service for the tax year. The $500,000 amount was reduced (but not below zero) by the amount by which the cost of "qualifying property" placed in service during the tax year exceeds $2 million. These amounts were indexed for inflation.

In general, "qualifying property" is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business, and includes off-the-shelf computer software and "qualified real property" (i.e., qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).

Passenger automobiles subject to the §280F limitation are eligible for §179 expensing only to the extent of the §280F dollar limitations. For sport utility vehicles above the 6,000 pound weight rating and not more than the 14,000 pound weight rating, which are not subject to the §280F limitation, the maximum cost that may be expensed for any tax year under §179 is $25,000.

NEW LAW: For property placed in service in tax years beginning after 12/31/17, the maximum amount a taxpayer may expense under §179 is increased to $1 million, and the phase-out threshold amount is increased to $2.5 million. For tax years beginning after 2018, these amounts (as well as the $25,000 sport utility vehicle limitation) are indexed for inflation. Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

"Qualified real property." The definition of §179 property is expanded to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging. The definition of qualified real property eligible for §179 expensing is also expanded to include the following improvements to nonresidential real property

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after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Temporary 100% Cost Recovery of Qualifying Business Assets

PRE-ACT LAW: An additional first-year bonus depreciation deduction was allowed equal to 50% of the adjusted basis of qualified property, the original use of which began with the taxpayer (e.g. new property), placed in service before 1/1/20 (1/1/21, for certain property with a longer production period). The 50% allowance was phased down for property placed in service after 12/31/17 (after 12/31/18 for certain property with a longer production period). A first-year depreciation deduction is also electively available for certain plants bearing fruit or nuts planted or grafted after 2015 and before 2020. Film productions aren't eligible for bonus depreciation.

NEW LAW: A 100% first-year deduction for the adjusted basis is allowed for qualified property acquired and placed in service after 9/27/17, and before 1/1/23 (after 9/27/17, and before 1/1/24, for certain property with longer production periods). Thus, the phase-down of the 50% allowance for property placed in service after 12/31/17, and for specified plants planted or grafted after that date, is repealed. The additional first-year depreciation deduction is allowed for new and used property. (The pre-Act law phase-down of bonus depreciation applies to property acquired before 9/28/17, and placed in service after 9/27/17.)

Caution: *The Act refers to the new 100% depreciation deduction in the placed-in-service year as "100% expensing," but the tax break should not be confused with expensing under §179, which is subject to entirely separate rules (see above).*

In later years, the first-year bonus depreciation deduction phases down, as follows:

- 80% for property placed in service after 12/31/22 and before 1/1/24
- 60% for property placed in service after 12/31/23 and before 1/1/25
- 40% for property placed in service after 12/31/24 and before 1/1/26
- 20% for property placed in service after 12/31/25 and before 1/1/27

For certain property with longer production periods, the beginning and end dates in the list above are increased by one year. For example, bonus first-year depreciation is 80% for long-production-period property placed in service after 12/31/23 and before 1/1/25.

For productions placed in service after 9/27/17, qualified property eligible for a 100% first-year depreciation allowance includes qualified film, television and live theatrical productions. 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).

For certain plants bearing fruit or nuts planted/ grafted after 9/27/17, and before 1/21/23, the 100% first-year deduction is available.

For the first tax year ending after 9/27/17, a taxpayer can elect to claim 50% bonus first-year depreciation (instead of claiming a 100% first-year depreciation allowance).

The election to accelerate AMT credits in lieu of bonus depreciation is repealed.

Luxury Automobile Depreciation Limits Increased (§280F)

§280F limits the §179 expensing and cost recovery deduction with respect to certain passenger autos.

PRE-ACT LAW: For passenger autos placed in service in 2017, for which the additional first-year depreciation deduction under §168(k) is not claimed, the maximum amount of allowable depreciation deduction is $3,160 for the year in which the vehicle is placed in service, $5,100 for the second year, $3,050 for the third year, and $1,875 for the fourth and later years in the recovery period. This limitation is indexed for inflation.

For passenger automobiles eligible for the additional first-year depreciation allowance in 2017, the first-year limitation is increased by an additional $8,000. This amount is phased down from $8,000 by $1,600 per calendar year beginning in 2018 Thus, the §280F increase amount for property placed in service during 2018 is $6,400, and during 2019 is $4,800.

Special rules also apply to “listed property”, such as any passenger auto; any other property used as a means of transportation; any property of a type generally used for purposes of entertainment, recreation, or amusement; and, under pre-Act law, any computer or peripheral equipment.

NEW LAW: For passenger automobiles placed in service after 12/31/17, in tax years ending after that date, for which the additional first-year depreciation deduction under §168(k) is not claimed, the maximum amount of allowable depreciation is increased to: $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. For passenger automobiles placed in service after 2018, these dollar limits are indexed for inflation. For passengers autos eligible for bonus first-year depreciation, the maximum first-year depreciation allowance remains at $8,000.

In addition, computer or peripheral equipment is removed from the definition of listed property, and so isn’t subject to the heightened substantiation requirements that apply to listed property.

For passenger automobiles acquired before 9/28/17, and placed in service after 9/27/17, the pre-Act phase-down of the §280F increase amount in the limitation on the depreciation deductions applies.

Recovery Period for Real Property Shortened

The cost recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method and mid-month convention are required for such real property.

PRE-ACT LAW:

- “Qualified leasehold improvement property” was an interior building improvement to nonresidential real property, by a landlord, tenant or sub-tenant, that was placed in service more than three years after the building is and that meets other requirements.
- “Qualified restaurant property” was either (a) a building improvement in a building in which more than 50% of the building’s square footage was devoted to the preparation of, and seating for, on-premises consumption of prepared

meals (the more-than-50% test), or (b) a building that passed the more-than-50% test.

- “Qualified retail improvement property” was an interior improvement to retail space that was placed in service more than three years after the date the building was first placed in service and that meets other requirements.
- “Qualified improvement property” is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service. “Qualified improvement property” does **not** include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

If a taxpayer elected the ADS, residential rental property had a recovery period of 40 years. ADS is principally a straight-line depreciation system under which one depreciation period (generally longer than any other) is prescribed for each class of recovery property.

NEW LAW: For property placed in service after 12/31/17, the separate definitions of “qualified leasehold improvement”, “qualified restaurant”, and “qualified retail improvement property” are **eliminated**, a general 15-year recovery period and straight-line depreciation are provided for “qualified improvement property”, and a 20-year ADS recovery period is provided for such property.

Thus, “qualified improvement property” placed in service after 12/31/17, is generally depreciable over 15 years using the straight-line method and half-year convention, **without regard** to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after 12/31/17, that does not meet the definition of “qualified improvement property”, is depreciable as nonresidential real property, using the straight-line method and the mid-month convention.

For property placed in service after 12/31/17, the ADS recovery period for residential rental property is reduced from 40 to 30 years.

For tax years beginning after 12/31/17, an electing farming business (i.e., a farming business electing out of the limitation on the deduction for interest) must use ADS to depreciate any property with a recovery period of 10 years or more (e.g., a single purpose agricultural or horticultural structures, trees or vines bearing fruit or nuts, farm buildings, and certain land improvements).

New Farming Equipment and Machinery Is 5-Year Property

PRE-ACT LAW: Depreciable assets used in agriculture activities that are assigned a recovery period of seven years include machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agriculture, animal husbandry, and horticultural services. Cotton ginning assets are also assigned a recovery period of seven years, while land improvements such as drainage facilities, paved lots, and water wells are assigned a recovery period of 15 years.

For new farm machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which began with the taxpayer after 12/31/08, and was placed in service before 1/1/10, a 5-year recovery period had applied.

Under pre-Act law, any property (other than nonresidential real property, residential rental property, and trees or vines bearing

fruits or nuts) used in a farming business was subject to the 150% declining balance method. Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct pre-productive period expenditures are required to depreciate all farming assets using the alternative depreciation system (ADS; i.e., using longer recovery periods and the straight-line method).

NEW LAW: For property placed in service after 12/31/17, in tax years ending after that date, the cost recovery period is shortened from seven to five years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which begins with the taxpayer.

In addition, the required use of the 150% declining balance depreciation method for property used in a farming business (i.e., for 3-, 5-, 7-, and 10-year property) is repealed. The 150% declining balance method continues to apply to any 15-year or 20-year property used in the farming business to which the straight-line method does not apply, and to property for which the taxpayer elects the use of the 150% de-clining balance method.

Observation: *Thus, farming property cab be depreciated under the 200% declining balance method except for (1) buildings and trees or vines bearing fruits or nuts (to which the straight-line method applies), (2) property for which the taxpayer elects either the straight-line method or 150% declining balance method, (3) 15- or 20-year MACRS property that has to be depreciated under the 150% declining bal-ance method, and (4) property subject to the ADS. Land improvements other than buildings are 15-year property, and fences and grain bins have a 7-year recovery period, and single-purpose agricultural or horticultural structures (e.g., greenhouses, specialized housing for live-stock) have a 10-year recovery period.*

DEDUCTIONS & EXCLUSIONS

Limits on Deduction of Business Interest

PRE-ACT LAW: Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations. For 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 the taxpayer's net investment income for the tax year.

§163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a tax year if:

• 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% of its "adjusted" taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under §199, depreciation, amortization, and depletion).

NEW LAW: For tax years beginning after 12/31/17, **every business**, regardless of its form, is **generally** subject to a disallowance of a deduction for net interest expense in excess of 30% of the business's adjusted taxable income. The net interest expense disallowance is determined at the tax filer level. However, a special rule applies to pass-through entitles, which requires the determination to be made at the entity level, for example, at the partnership level instead of the partner level.

For tax years beginning after 12/31/17 and before 1/1/22, "adjusted" taxable income is computed **without** regard to deductions allowable for depreciation, amortization, or depletion and without the former §199 deduction (which is repealed effective 12/31/17).

The following exemptions, elections and exceptions are available:

- An **exemption** from these rules applies for taxpayers (other than tax shelters) with average annual gross receipts for the three-tax year period ending with the prior taxable year that do not exceed $25 million.
- The business-interest-limit provision does not apply to certain regulated public utilities and electric cooperatives.
- Real property trades or businesses can **elect out** of the provision if they use ADS to depreciate applicable real property used in a trade or business.
- Farming businesses can also **elect out** if they use ADS to depreciate any property used in the farming business with a recovery period of ten years or more.
- An **exception** from the limitation on the business interest deduction is also provided for floor plan financing (i.e., financing for the acquisition of motor vehicles, boats or farm machinery for sale or lease and secured by such inventory).

Partnerships. 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 for any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30% 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% of the adjusted taxable income of the partnership. As a result, a partner of a partnership can deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. Excess taxable income is allocated in the same manner as non-separately stated income and loss. Similar to these rules also apply to S corpora-tions.

Special rule for carryforward of disallowed partnership interest. In the case of a partnership, any business interest that is not allowed as a deduction to the partnership for the tax year is allocated to each partner in the same manner as non-separately stated taxable income or loss of the partnership. The partner may deduct its share 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 carry-forward. Any such deduction requires a corresponding reduction in excess taxable income. In addition, 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 rule does not apply to S corporations and their shareholders.

Modification of Net Operating Loss (NOL) Deduction

PRE-ACT LAW: An NOL may generally be carried back 2 years and carried over 20 years to offset taxable income in such years. However, different carryback periods apply with respect to NOLs arising in different circumstances. For example,

extended carryback periods are allowed for NOLs attributable to specified liability losses and certain casualty and disaster losses.

NEW LAW: For NOLs arising in tax years ending after 12/31/17, the 2 year carryback and the special carryback provisions are repealed, but a 2 year carryback applies in the case of certain losses incurred in the trade or business of farming.

For losses arising in tax years beginning after 12/31/17, the NOL deduction is limited to 80% of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and, except as provided below, NOLs can be carried forward indefinitely.

However, NOLs of property and casualty insurance companies can be carried back 2 years and carried over 20 years to offset 100% of taxable income in such years.

TAX CREDITS & DEDUCTIONS

Domestic Production Activities Deduction (DPAD) Repealed

PRE-ACT LAW: Taxpayers could claim a DPAD under §199 equal to 9% (6% in the case of certain oil and gas activities) of the lesser of the taxpayer's qualified production activities income or the taxpayer's taxable income for the tax year. The deduction was limited to 50% of the W-2 wages paid by the taxpayer during the calendar year. Qualified production activities income was equal to domestic production gross receipts less the cost of goods sold and expenses properly allocable to such receipts. Qualifying receipts were derived from property that was manufactured, produced, grown, or extracted within the U.S.; qualified film productions; production of electricity, natural gas, or potable water; construction activities performed in the U.S.; and certain engineering or architectural services.

NEW LAW: For tax years beginning after 12/31/17, the DPAD is repealed.

Like-Kind Exchange Treatment Limited

PRE-ACT LAW: The like-kind exchange rule provided that no gain or loss was recognized to the extent that property-which included a wide range of property from real estate to tangible personal property-held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged for property of a like-kind that also is held for productive use in a trade or business or for investment.

NEW LAW: Generally effective for transfers after 12/31/17, the rule allowing the deferral of gain on like-kind exchanges is modified to allow for like-kind exchanges **only** with respect to real property that is **not** held primarily for sale. However, under a transition rule, the pre-Act like-kind exchange rules apply to exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before 12/31/17.

Employer's Deduction for Fringe Benefit Expenses Limited

PRE-ACT LAW: A taxpayer may deduct up to 50% of expenses relating to meals and entertainment. Housing and meals provided for the convenience of the employer on the business premises of the employer are **excluded** from the employee's

gross income. Various other fringe benefits provided by employers are **not** included in an employee's gross income, such as qualified transportation fringe benefits

NEW LAW: For amounts incurred or paid after 12/31/17, deductions for entertainment expenses are **disallowed**, eliminating the subjective determination of whether such expenses are sufficiently business related; the current 50% limit on the deductibility of business meals is **expanded** to meals provided through an in-house cafeteria or otherwise on the premises of the employer; and deductions for employee transportation fringe benefits (e.g., parking and mass transit) are denied, but the exclusion from income for such benefits received by an employee is retained. In addition, no deduction is allowed for transportation expenses that are the equivalent of commuting for employees (e.g., between the employee's home and the workplace), except as provided for the safety of the employee.

For tax years beginning after 12/31/25, the Act will disallow an employer's deduction for expenses associated with meals provided for the convenience of the employer on the employer's business premises, or provided on or near the employer's business premises through an employer-operated facility that meets certain requirements.

Nondeductible Penalties and Fines

PRE-ACT LAW: No deduction is allowed for fines or penalties paid to a government for the violation of any law.

NEW LAW: For amounts generally paid or incurred on or after the date of enactment (see below), no deduction is allowed for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. An **exception** applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance. IRS remains free to challenge the characterization of an amount so identified; however, no deduction is allowed unless the identification is made.

An exception also applies to any amount paid or incurred as taxes due.

Restitution for failure to pay any tax, that is assessed as restitution under the Code is deductible only to the extent it would have been allowed as a deduction if it had been timely paid.

Government agencies (or entities treated as such) must report to IRS and to the taxpayer the amount of each settlement agreement or order entered into where the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or such other amount as may be specified by IRS). The report must separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The report must be made at the time the agreement is entered into, as determined by IRS.

The provisions **don't** apply to amounts paid or incurred under any binding order or agreement entered into **before the date of enactment.** But this exception would not apply to an order or agreement requiring court approval unless the approval was obtained before the enactment date.

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Employee Achievement Awards

Employee achievement awards are excludable to the extent the employer can deduct the cost of the award-generally limited to $400 for any one employee, or $1,600 for a "qualified plan award." An employee achievement award is an item of tangible personal property given to an employee in recognition of either length of service or safety achievement and presented as part of a meaningful presentation.

NEW LAW: For amounts paid or incurred after 12/31/17, a definition of "tangible personal property" is provided. Tangible personal property does **not** include cash, cash equivalents, gifts cards, gift coupons, gift certificates (other than where from the employer pre-selected or pre-approved a limited selection) vacations, meals, lodging, tickets for theatre or sporting events, stock, bonds or similar items, and other non-tangible personal property. No inference is intended that this is a change from present law and guidance.

New Credit for Employer-Paid Family and Medical Leave

Under pre-Act law, no credit is provided to employers for compensation paid to employees while on leave.

NEW LAW: For wages paid in tax years beginning after 12/31/17, but not beginning after 12/31/19, the Act allows businesses to claim a general business credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave (FMLA) if the rate of payment is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%. All qualifying full-time employees have to be given at least two weeks of annual paid family and medical leave (all less-than-full-time qualifying employees have to be given a commensurate amount of leave on a pro rata basis).

"Tax Credits & Deductions" Outside the Scope of this Tax Planning Letter

- Five-Year Write-off of Specified Research & Experimentation (R&E) Expenses
- No Deduction for Amounts Paid for Sexual Harassment Subject to Non-Disclosure Agreement
- Limitation on Excessive Employee Compensation with Respect to a Covered Employee of a Publicly Traded Corporation
- Deduction for Local Lobbying Expenses Eliminated
- Orphan Drug Credit Modified
- Rehabilitation Credit Limited

ACCOUNTING METHOD CHANGES

Taxable Year of Inclusion

In general, for a cash basis taxpayer, an amount is included in income when actually or constructively received. For an accrual basis taxpayer, an amount is included in income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (i.e., when the "all events test" is met), unless an exception permits deferral or exclusion. A number of exceptions that exist to permit deferral of income relate to advance

payments. An advance payment is when a taxpayer receives payment before the taxpayer provides goods or services to its customer. The exceptions often allow tax deferral to mirror financial accounting deferral (e.g., income is recognized as the goods are provided or the services are performed).

NEW LAW: Generally for tax years beginning after 12/31/17, a taxpayer is required to recognize income no later than the tax year in which such income is taken into account as income on an applicable financial statement (AFS) or another financial statement under rules specified by IRS (subject to an exception for long-term contract income under §460).
The Act also codifies the current deferral method of accounting for advance payments for goods and services provided by Rev Proc 2004-34 to allow taxpayers to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.

In the case of any taxpayer required by this provision to change its accounting method for its first tax year beginning after 12/31/17, such change will be treated as initiated by the taxpayer and made with IRS's consent.

Cash Method of Accounting

PRE-ACT LAW: A corporation, or a partnership with a corporate partner, may generally only use the cash method of accounting if, for **all** earlier tax years beginning after 12/31/85, the corporation or partnership met a gross receipts test (i.e., the average annual gross receipts the entity for the three-tax-year period ending with the earlier tax year does not exceed $5 million). Under current law, farm corporations and farm partnerships with a corporate partner may only use the cash method of accounting if their gross receipts do not exceed $1 million in any year. An exception allows certain family farm corporations to qualify if the corporation's gross receipts do not exceed $25 million. Qualified personal service corporations are allowed to use the cash method without regard to whether they meet the gross receipts test.

NEW LAW: For tax years beginning after 12/31/17, the cash method may be used by taxpayers (other than tax shelters) that satisfy a $25 million gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. Under the gross receipts test, taxpayers with annual average gross receipts that do not exceed $25 million (indexed for inflation for tax years beginning after 12/31/18) for the three prior tax years are allowed to use the cash method.

The exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations are retained. Accordingly, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of the method clearly reflects income.

Use of this provisions results is a change in the taxpayer's accounting method for purposes of §481.

Accounting for Inventories

PRE-ACT LAW: Businesses that are required to use an inventory method must generally use the accrual accounting method. However, the cash method can be used for certain small businesses that meet a gross receipt test with average gross receipts of not more than $1 million ($10 million businesses in certain industries). These businesses account for inventory as non-incidental materials and supplies.
NEW LAW: For tax years beginning after 12/31/17, taxpayers that meet the $25 million gross receipts test are not required to account for inventories under §471, but rather may use an accounting method for inventories that either (1) treats

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inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

Use of this provisions results is a change in the taxpayer's accounting method for purposes of §481.

Capitalization and Inclusion of Certain Expenses in Inventory Costs

The uniform capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of such property. However, under pre-Act law, a business with average annual gross receipts of $10 million or less in the preceding three years is not subject to the UNICAP rules for personal property acquired for resale. The exemption does not apply to real property (e.g., buildings) or personal property that is manufactured by the business.

NEW LAW: For tax years beginning after 12/31/17, any producer or re-seller that meets the $25 million gross receipts test is exempted from the application of §263A. The exemptions from the UNICAP rules that are not based on a taxpayer's gross receipts are retained.

Use of this provision results is a change in the taxpayer's accounting method for purposes of §481.

"Accounting Method Changes" Outside the Scope of this Tax Planning Letter

• Accounting for Long-Term Contracts

OTHER PROVISIONS
(Outside the Scope of this Tax Planning Letter)

• Costs of Replanting Citrus Plants Lost Due to Casualty
• Exclusions from Contributions to Capital
• Repeal of Rollover of Publicly Traded Securities Gain into Specialized SBICs
• Tax Incentives for Investment in Qualified Opportunity Zones

Questions?

For more details on information presented in this Tax Planning Letter or other issues, please feel free to call Roger Rossmeisl, CPA direct at (714) 325-0442 or via e-mail at roger@khopatel.com.

This Tax Planning Letter is assembled by Roger Rossmeisl and is intended to provide accurate, general information on the matters contained herein and it should not be construed as offering accounting or legal advice or accounting or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. Since tax laws are constantly changing, and are subject to differing interpretations, you are urged to do additional research before acting on the information contained in this document.

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