Hogan Lovells

Sweeping U.S. Tax Bill signed into law

The provisions of the new tax law – almost all of which go into effect on January 1, 2018 – represent the most significant revisions to the U.S. tax code that have occurred in 30 years. The Act makes sweeping and major changes that will affect any business, domestic or multinational, with operations in the U.S.

December 27, 2017

On December 22, 2017 the U.S. president signed into law the U.S. tax reform legislation that had passed the U.S. House of Representatives and U.S. Senate earlier this week.

The new law makes sweeping and significant changes to the U.S. tax code that will affect any business with operations in the U.S. Although many businesses will see significant tax reductions from the legislation, others will see significant tax increases. The consequences for businesses, even those in the same industry, are very much dependent on the profile of the particular business, including existing organizational structure and tax planning efforts already in place. Most of these changes go into effect on January 1, 2018.

The following outlines some of the highlights of the final law. We also offer our thoughts on the significance of the provisions for business taxpayers (U.S. and non-U.S. based), and issues of importance to certain industries.

We are happy to discuss with you specific provisions, and compliance and other issues that will arise as a result of these changes in U.S. tax law.

Key highlights – Business tax provisions

U.S. corporate tax rate

— The new U.S. corporate rate is 21 percent – reduced from 35 percent – effective after December 31, 2017.

Corporate alternative minimum tax

— The corporate alternative minimum tax (AMT) is eliminated, effective for taxable years beginning after December 31, 2017.

— AMT credit carryovers from previous taxable years can be used to reduce regular tax liability, and, to the extent they exceed regular tax liability, are refundable, in the amount of 50 percent of excess AMT credit carryovers in 2018, 2019 and 2020, with 100 percent of any remaining AMT credit carryover available for use in 2021.

Pass-through rate

— For tax years beginning after 2017 and before 2026, partners/interest-holders (including real estate investment trusts (REIT), master limited partnerships (MLP), and trust interest holders) can deduct 20 percent of qualified business income, (resulting in a 29.6 percent top rate for qualified business pass-through income). For taxpayers with such income exceeding $315,000 (married filing jointly, and indexed), the deduction benefit for income that is from "specified service businesses" (law, accounting, medical care, consulting, performing arts, athletics, financial services and similar income) is phased out over the next $100,000. Phase-outs (at the same dollar levels) also apply to all qualified business income to the extent it exceeds the greater of: 1) 50 percent of W-2 wages paid with respect to the qualified business; or 2) 25 percent of such wages plus 2.5 percent of the basis (meaning basis when acquired) of depreciable tangible property used in the production of qualified business income, and not fully depreciated and more than 10 years old (from date of first being placed in service.) Qualified business income does not include passive income such as dividends, investment interest income, capital gains income, and commodity and currency gains. Certain REIT dividends are allowable as qualified business income.

Capital expensing

— One hundred percent expensing for qualified property placed in service after September 27, 2017 and before January 1, 2023. Phase down – 80 percent expensing in 2023, 60 percent in 2024, 40 percent in 2025, 20 percent in 2026. (With an additional year to place in service for long production period property such as aircraft.) Regulated utility property and vehicle dealer floor plan financing property are not eligible for expensing.

Interest expense deductibility

— Net interest expense (that which exceeds interest income) deductible – for taxable years beginning after 2017 and before 2022, – only up to 30 percent of earnings before interest, taxes, depreciation, and amortization earnings before interest, taxes, depreciation, and amortization (EBITDA). For taxable years beginning after 2021, deductible net interest expense cannot exceed 30 percent of earnings before interest and tax (EBIT), which is income after the deductions for depreciation and amortization and hence is a significantly more onerous limit than EBITDA for some industries. Regulated utilities, farming businesses, real property trades using Alternative Depreciation System (ADS) depreciation and motor vehicle dealers with floor plan financing all have exemptions from the limitation.

Net Operating Losses (NOLs)

— Repeals carryback for NOLs for taxable years ending after 2017 (except for farming losses and property and casualty insurance companies). Allows unlimited carryforwards for NOLs arising in taxable years ending after 2017, but only to the extent of 80 percent of taxable income.

Like Kind Exchange (LKE) deferral

— Retains LKE for real property, but repeals for personal property.

Carried interest

— Carried interest must hold for three years for long term gain (lower capital gains rate).

Real property – Depreciation

— Maintains present law 39 and 27.5 year Modified Accelerated Cost Recovery System (MACRS) recovery periods for nonresidential and residential real property. Provides a 15 year recovery period for qualified improvement property (interior improvements to nonresidential real property). For real property businesses electing out of the limitations on the deductibility of interest expense, provides 40 and 30 year ADS recovery periods for nonresidential and residential rental real property.

Life insurance tax provisions

— Extends amortization for policy acquisition expenses; modifies accounting for life insurance reserves.

International provisions (Applicable to businesses with income/operations in the U.S. and outside the U.S., inbound and outbound)

One-time deemed repatriation tax for U.S.-based companies with foreign subsidiaries

— One-time tax (via a deduction applied to a mandatory inclusion) on all accumulated earnings and profits of U.S. controlled foreign corporations (CFCs) at a rate of 15.5 percent for cash equivalents and a rate of eight percent for non-cash equivalents. Foreign tax credits are allowed with respect to the taxable portion of the mandatory inclusion.

Territorial U.S. system

— Territorial system, 100 percent Dividends Received Deduction (DRD) (i.e. no tax on repatriation of foreign income) with exceptions (base erosion measures).

U.S. CFC "intangible income" taxable

— Global Intangible Low-Taxed Income (GILTI) of CFCs is includible as taxable income to the U.S. shareholder, in a manner similar to Subpart F income. GILTI means, in general, the income of the CFC that exceeds an allowed return (10 percent) on tangible property (qualified business asset investments). Intangible property is not considered qualified business asset investments (i.e. is counted as zero in determining qualified business asset investments). A credit is provided for 80 percent of foreign taxes paid and attributable to such income. Corporate (but not individual) U.S. shareholders are allowed a deduction equal to 50 percent – reduced to 37.5 percent starting in 2026 – of any GILTI included in their taxable income, resulting in a net tax rate on GILTI of 10.5 percent, and 13.125 percent in 2026 and after.

Base erosion excise / Anti-abuse tax for U.S. payments to non-U.S. related party

— "BEAT" tax, an alternative minimum tax on U.S. corporate taxpayers with annual gross receipts exceeding $500 million, equal to five percent for 2018 (increasing to 10 percent for 2019-2024 and further increasing to 12.5 percent after 2025) of (modified) taxable income, without allowing deductions for normally deductible U.S. payments to a foreign related party, though still allowing deductions for such payments if they are for cost-of-goods-sold, and only allowing a portion of general business tax credits (portion of energy and housing credits allowed prior to 2026).

Hogan Lovells comments

This new law is the most significant U.S. tax reform legislation in more than 30 years. It will take months and years to fully understand the significance of, and opportunities and risks associated with, some of the more significant changes to the U.S. tax code contained in this bill. It will take at least this long for regulators to provide more guidance to clarify ambiguities in the law. A few notes worth mentioning:

— Many businesses, in particular multinational businesses, will find that the benefits of the lower U.S. tax rate and other items such as full capital expensing may not offset the tax increases associated with provisions like the base erosion taxes. The net impact of this Act on any particular business will depend very much on the particular characteristics of the business and its (domestic and/or global) operations, and could be very different even for businesses in the same industries.

— The deduction for pass-through business income may create potential for tax structuring benefits. This provision will undoubtedly prove challenging for regulators tasked with producing regulations and guidance to clarify this aspect of the new law.

— We expect at a minimum a technical corrections bill that will move through Congress in 2018 to fix and modify provisions in this bill that do not turn out as intended. This means that those affected taxpayers who did not speak up or examine the tax bill on this round may have one additional opportunity to influence fixes in a bill next year.

We would advise businesses to engage now to ensure that they fully understand the consequences of this bill for their tax situation. In addition, for those with important issues that will be influenced (positively or negatively) by regulations and guidance, and/or follow-up tax legislation in 2018, we urge you to seek assistance promptly to make sure your voice is heard.

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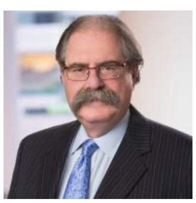

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