WHAT THE NEW TAX ACT MEANS FOR YOUR BUSINESS

By Robert C. Pozen

Senior Lecturer, MIT Sloan

LOWER CORPORATE TAX RATE

1. Lower the Corporate Tax Rate from 35% to 21%

    -Average OECD Rate= 24%

2. Repeal Corporate AMT

    - Used to be 20%

USE OF HIGHER AFTER-TAX PROFITS

1. No limit on increases in dividends or share buy backs.

2. Encourages investment in new plant and equipment
   - Immediate expensing until end of 2022
   - Phase out 2023-2027

3. But unclear how much incremental capital investments will be made by Corporate America.

LESS FAVORABLE CORPORATE DEDUCTIONS

1. Interest deductions limited to 30% of:
   - EBITDA from 2018 to 2021
   - EBIT from 2022 and after

2. Amortization of research expenditures
   -Begins after 2021
   -R+D tax credit retained

3. Limits deductions for NOLs (net operating losses)
   -80% of losses after 2017
   -NOLs carried forward, not backward

PLUSES AND MINUSES FOR CERTAIN INDUSTRIES

1. Real estate
   -Exempt from 30% limit on interest deductions
   -Like-kind exchanges only for real property

2. Carried interest:
   -taxed as capital gains if held for 3 years

3. Suspends all miscellaneous deductions from 2018-2025,
   so individuals will not be able to
   deduct investment fees and expenses.

4. Reduces orphan drug tax credit from 50% to 25%

PASS-THROUGHS—DEFINITIONS

1. Pass-throughs include:

   Sole proprietorships, partnerships, limited liability companies, and subchapter S corporations

2. Qualified business income includes all income from pass-throughs,

   -plus REIT income (other than capital gains)
   -plus income from publicly traded partnerships

   -but *not* capital gains, dividends, and investment interest,

   -and *not* reasonable compensation or guaranteed payments to active partners or executives

3. But Act limits deductions for service firms:

   - where the principal asset is the reputation or skill of the employees, and

   - firms performing specified services: in health, law, consulting, athletics and

   all kinds of financial services (e.g., trading or investing)

REDUCED RATES FOR PASS-THROUGH INCOME

1. New 20% deduction for qualified business income
   from pass-throughs:
   -reduces top tax rate on such income to 29.6%
   -assumes new top individual rate of 37%

2. However, the Act imposes two different limits on the 20% deduction for higher income taxpayers:
   -$157,500 for individuals
   -$315,000 for couples

3. Over these income levels, the 20% deduction is limited by
   50% of W-2 wages; or if greater:
   25% of W-2 wages + 2.5% of tangible capital costs

4. Moreover, for business income from firms performing services,
   the 20% deduction is rapidly phased out over these income levels.

FROM WORLDWIDE TO TERRITORIAL SYSTEM

1. Under current worldwide system, most profits of US corps in all foreign countries are taxed by the US
   - Only if and when they are repatriated to the US
   - Over $2.5 trillion in foreign profits held abroad

2. Under new territorial system, most profits of US corps will be taxed only in the country where the profits were earned.
   - Tax havens like Bermuda have NO corporate tax on local income
   - Countries like Switzerland and Singapore will levy taxes less than 10% on corporate income for facilities there

MINIMUM TAX ON FOREIGN PROFITS

1. The Act establishes a minimum tax of up to 13.125% on foreign profits

   -- If a US firm paid 8% on its foreign profits, it would owe US taxes of 5.125%

2. But the Act allows US firms to use an aggregate rate on foreign profits

   -offsetting minimal rates in tax havens

   -with higher rates in other countries

3. Moreover, before applying the minimum tax, the Act reduces a US firm's foreign profits by its "routine" profits–

   -An assumed 10% return on its tangible assets abroad

   -$100 million profit would be reduced by $30 million if $300 million in tangible assets abroad

PAST FOREIGN PROFITS HELD ABROAD

1. Mandatory repatriation tax on all past foreign profits held abroad: (payable over 8 years)
    - 15.5% on profits held in cash equivalents
    - 8% on profits held in illiquid assets

2. Once these taxes are paid, such foreign profits may be moved back to the US without more taxes

2. Since these taxes must be paid regardless of actual repatriations, US firms will have an incentive to use these profits in the US

POLITICS OF BUDGET RECONCILIATION

- Reduction in individual tax rates	Ends 2025
- 20% deduction for pass throughs	Ends 2025
- $10,000 cap on state-local deductions	Ends 2025
- Doubling of estate tax exemption	Ends 2025
- Reduction in corporate tax rate	Permanent
- Repeal of Corporate AMT	Permanent