

Tax Cuts and Jobs Act Corporations

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The Tax Cuts and Jobs Act is the biggest federal tax law change in over 30 years. Below are some significant changes affecting corporations. **Note:** Except where noted, the changes are effective for tax years 2018–2025.

Corporation Tax Rates

Changes have been made to the corporation tax rates, which under prior law contained several graduated tax brackets. For tax years beginning after 2017:

- All taxable income of a C corporation is taxed at a flat tax rate of 21%.
- There is no longer a separate tax rate for a personal service corporation (PSC). Previously, a PSC paid a flat 35% tax rate on all taxable income.
- There is no longer a separate maximum tax rate on net long-term capital gains. All corporation income is taxed at 21%.
- The allowable deduction for dividends received from other taxable domestic corporations has been reduced from 70% to 50% of the dividends received, and for a 20% owned corporation the percentage has been reduced from 80% to 65%. Shareholders of surrogate foreign corporation are not eligible for the reduced rate on dividends.

Alternative Minimum Tax (AMT)

Prior Law. AMT was imposed on a C corporation to the extent the corporation's tentative minimum tax exceeded its regular tax. This tentative minimum tax was computed at the rate of 20% on alternative minimum taxable income (AMTI) in excess of a \$40,000 exemption amount that phased out. A corporation with average gross receipts of less than \$7.5 million for the prior three

tax years was exempt from the corporate AMT. The \$7.5 million threshold was reduced to \$5 million for the corporation's first three-taxable year period.

If a corporation was subject to AMT in any year, the amount of AMT was allowed as an AMT credit in any subsequent tax year to the extent the taxpayer's regular tax liability exceeded its tentative minimum tax in the subsequent year. Corporations were allowed to claim a limited amount of AMT credits in lieu of bonus depreciation.

New Law. Effective for tax years after 2017, the AMT for corporations is repealed.

AMT credits are allowed to offset the regular tax liability for any tax year. In addition, the AMT credit is refundable for any tax year 2018 through 2020 in an amount equal to 50% 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. For tax year 2021, the 50% refundable amount is increased to 100%. So, the full amount of any minimum tax credit remaining will be allowed in full for a tax year beginning in 2021.

Accounting Methods

Prior Law. Under the general rule, the accrual method of accounting is required for purchases and sales if it is necessary to keep an inventory in order to clearly reflect income. An exception applies if average annual gross receipts are \$1 million or less and the cash method may be used even if inventories are kept. However, a deduction for inventory costs is not allowed until the inventory item is sold or paid for, whichever is later. If average annual gross receipts are \$10 million or less, service type industries can use the cash method even if inventories are kept.



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Farming C corporations and farming partnerships with C corporation partners (except family farming C corporations) are required to use the accrual method if average annual gross receipts are over \$1 million. Family farming C corporations and family farming partnerships with C corporation partners are not required to use the accrual method until average annual gross receipts exceed \$25 million.

New Law. Effective beginning in 2018, the new law expands the number of taxpayers that may use the cash method of accounting. The cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test (average annual gross receipts that do not exceed \$25 million for the three prior tax-year period), regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The \$25 million amount is indexed for inflation for tax years beginning after 2018. Farming C corporations (and farming partnerships with a C corporation partner) may now use the cash method if it meets the \$25 million gross receipts test.

The new law retains the exceptions from the required use of the accrual method for qualified personal service corporations (PSCs) and taxpayers other than C corporations. PSCs, 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 such method clearly reflects income. C corporations, in contrast, that do not meet the \$25 million gross receipts test are required to use the accrual method.

S Corporation Conversion to C Corporation

Prior Law. IRC section 481 prescribes the rules in computing taxable income when a different accounting method was used in a prior year. For example, if an S corporation that was permitted to use the cash method of accounting converts to a C corporation that is required to use the accrual method of accounting, the conversion would result in a change of accounting method which could trigger the IRC section 481 rules.

In computing taxable income for the year of change, an adjustment is made to prevent items of income or expense from being duplicated or omitted. The year of change is the tax year for which the taxable income of the taxpayer is computed under a different method than the prior year.

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.

New Law. Effective December 22, 2017, any IRC 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. An eligible terminated S corporation is any C corporation which:

- Is an S corporation on December 21, 2017,
- During the 2-year period beginning on December 22, 2017, revokes its S corporation election under IRC section 1362(a), and
- All of the owners on the date the S corporation election is revoked are the same owners (and in identical proportions) as the owners on December 22, 2017.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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