CORPORATIONS

¶305 21-Percent Corporate Income Tax Rate

NEW LAW EXPLAINED

21-percent flat corporate income tax rate established; normalization requirements provided.—Reduction in corporate tax rate. For tax years beginning after December 31, 2017, the graduated corporate rate structure is eliminated and corporate taxable income is taxed at a 21-percent flat rate (Code Sec. 11(b), as amended by the Tax Cuts and Jobs Act).

> **COMMENT**
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> The lower corporate tax rate will allow domestic corporations to remain globally competitive and will increase international investments in the United States. Also, it is expected that the lower corporate tax rate will lead to economic growth and jobs creation because U.S. corporations will have more money to invest. In addition, the lower corporate tax rate will provide less incentives for U.S. companies to shift operations and employees abroad and will encourage investment of their foreign earnings into business expansion and employment in the United States.

The alternative tax for net capital gains is repealed (Act Sec. 13001(b)(2) of the 2017 Tax Cuts Act, striking Code Sec. 1201).

> **COMMENT**
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> The alternative tax is obsolete in light of the new 21-percent corporate tax rate.

Other changes. A definition of undistributed capital gain is provided for purposes of the rules related to the taxation of REITs on net capital gains. Specifically, undistributed capital gain is the excess of the net capital gain over the deduction for dividends paid (as defined in Code Sec. 561) determined with reference to capital gain dividends only (Code Sec. 857(b)(3)(F), as amended by the 2017 Tax Cuts Act).

The new law also clarifies that, for purposes of the capital gain rate differential adjustment in determining the foreign tax credit limitation, there is a capital gain rate differential for any year if Code Sec. 1(h) applies to the tax year. In addition, the rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as (1) the excess of (i) the highest rate of tax set forth in Code Sec. 1(a), (b), (c), (d), or (e) (whichever applies), over (ii) the alternative rate of tax determined under Code Sec. 1(h), bears to (2) the rate referred to in item (i) (Code Sec. 904(b)(3)(D) and (E), as added by the 2017 Tax Cuts Act).

Moreover, the rules for withholding of tax on dispositions of U.S. real property are modified to replace the 35-percent tax required to be withheld on certain dispositions by domestic partnerships, estates and trusts, and distributions by foreign corporations, REITs, and RICs with the highest rate of tax in effect for the tax year under Code Sec. 11(b) (Code Sec. 1445(e), as amended by the 2017 Tax Cuts Act).

In addition, the provision disallowing the graduated corporate rates or the accumulated earnings credit to transferee corporations upon certain transfers is repealed (Act Sec. 13001(b)(5) of the 2017 Tax Cuts Act, striking Code Sec. 1551).

The new law further modifies the former rules limiting the use of multiple tax benefits of controlled group of corporations to leave only the limitation on the use of the accumulated earnings credit. Specifically, the component members of a controlled group of corporations on a December 31 are limited, for purposes of Subtitle A of the Code, for their tax years which include that December 31, to one $250,000 ($150,000 if any component member is a personal service corporation) accumulated earnings credit under Code Sec. 535(c). This amount must be divided equally among the component members of the group on that

December 31, unless an unequal allocation is allowed by regulations (Code Sec. 1561(a), as amended by the 2017 Tax Cuts Act).

COMMENT

This change reflects the repeal of the corporate alternative minimum tax and the elimination of the graduated corporate rate structure by the 2017 Tax Cuts Act.

If a corporation has a short tax year that does not include a December 31 and is a component member of a controlled group of corporations with respect to that tax year, then for purposes of Subtitle A of the Code, the amount used in computing the accumulated earnings credit of the corporation for that tax year is determined by dividing $250,000 (or $150,000) by the number of corporations that are component members of the group on the last day of that tax year. For this purpose, the definition of component member in Code Sec. 1563(b) is applied as if the last day were substituted for December 31 (Code Sec. 1561(b), as amended by the 2017 Tax Cuts Act).

COMMENT

The effective date provided for the amendment to Code Sec. 1561 is for transfers made after December 31, 2017 (Act Sec. 13001(c)(3) of the 2017 Tax Cuts Act). However, this effective date does not appear to be correct given the subject and application of Code Sec. 1561. More likely, the amendment to Code Sec. 1561 should apply to tax years beginning after December 31, 2017. Also, it is likely that the effective date for transfers made after December 31, 2017, is intended to apply to the repeal of Code Sec. 1551, which concerns transfers to corporations.

Normalization requirements. For taxpayers subject to the normalization method of accounting (e.g., regulated public utilities), the new law 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 corporate rate reduction takes effect).

Specifically, a taxpayer is not treated as using a normalization method of accounting with respect to any public utility property for purposes of Code Sec. 167 or 168, if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method (Act Sec. 13001(d)(1) of the 2017 Tax Cuts Act).

For this purpose, the excess tax reserve is the excess of:

- the reserve for deferred taxes (described in Code Sec. 168(i)(9)(A)(ii)) as of the day before the corporate rate reductions (provided in the amendments made by Act Sec. 13001 of the 2017 Tax Cuts Act) take effect, over
- the amount which would be the balance in the reserve if the amount of the reserve were determined by assuming that the corporate rate reductions were in effect for all prior periods (Act Sec. 13001(d)(3)(A) of the 2017 Tax Cuts Act).

The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in the taxpayer’s regulated books of account that gave rise to the reserve for deferred taxes. Under this method, during the time period in which timing differences for the property (i.e., differences between tax depreciation and regulatory depreciation with respect to the property) reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying:

- the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by
- the amount of the timing differences that reverse during that period (Act Sec. 13001(d)(3)(B) of the 2017 Tax Cuts Act).]

COMMENT

In other words, under this method, the excess tax reserve is reduced as the timing differences reverse over the remaining life of the asset. To ensure that the deferred tax reserve, including the excess tax reserve, is reduced to zero at the end of the regulatory life of the asset that generated the reserve, the amount of the timing difference that reverses during a tax year is multiplied by the ratio of (1) the aggregate deferred taxes as of the beginning of the period in question to (2) the aggregate timing differences for the property as of the beginning of the period in question.

COMMENT

The reversal of timing differences generally occurs when the amount of the tax depreciation taken with respect to an asset is less than the amount of the regulatory depreciation taken with respect to the asset.

EXAMPLE

A calendar year regulated utility placed property costing $100 million in service in 2016. For regulatory (book) purposes, the property is depreciated over 10 years on a straight line basis with a full year's allowance in the first year. For tax purposes, the property is depreciated over 5 years using the 200 percent declining balance method and a half-year placed in service convention.

Normalization calculation for corporate rate reduction											
(Millions of dollars)											
Year(s)											
	2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**Total**
Tax expense	20	32	19.2	11.52	11.52	5.76	0	0	0	0	100
Book depreciation	10	10	10	10	10	10	10	10	10	10	100
Timing difference	10	22	9.2	1.52	1.52	(4.24)	(10)	(10)	(10)	(10)	0
Tax rate	35%	35%	21%	21%	21%	31.1%	31.1%	31.1%	31.1%	31.1%	
Annual adjustment to reserve	3.5	7.7	1.9	0.3	0.3	(1.3)	(3.1)	(3.1)	(3.1)	(3.1)	0
Cumulative deferred tax reserve	3.5	11.2	13.1	13.5	13.8	12.5	9.3	6.2	3.1	(0.0)	0
Annual adjustment at 21%		(0.9)	(2.1)	(2.1)	(2.1)	(2.1)	(9.3)				
Annual adjustment at average rate		(1.3)	(3.1)	(3.1)	(3.1)	(3.1)	(13.8)				
Excess tax reserve						0.4	1.0	1.0	1.0	1.0	4.5

The excess tax reserve as of December 31, 2017, the day before the corporate rate reduction takes effect, is $4.5 million (the cumulative deferred tax reserve as of December 31, 2017 ($11.2 million), minus the cumulative timing difference as of December 31, 2017 ($32 million), multiplied by 21 percent). The taxpayer will begin taking the excess tax reserve into account in the 2021 tax year, which is the first year in which the tax depreciation taken with respect to the property is less than the depreciation reflected in the regulated books of account. The annual adjustment to the deferred tax reserve for the 2021 through 2025 tax years is multiplied by 31.1 percent, which is the ratio of the aggregate deferred taxes as of the beginning of 2021 ($13.8 million) to the aggregate timing differences for the property as of the beginning of 2021 ($44.2 million) (Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466)).

Alternative method for certain taxpayers. If, as of the first day of the tax year that includes December 22, 2017:

- the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and
- the taxpayer's books and underlying records did not contain the vintage account data necessary to apply the average rate assumption method, then
- the taxpayer is treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction (Act Sec. 13001(d)(2) of the 2017 Tax Cuts Act).

For this purpose, the alternative method is the method in which the taxpayer:

- computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and
- reduces the excess tax reserve ratably over the remaining regulatory life of the property (Act Sec. 13001(d)(3)(C) of the 2017 Tax Cuts Act).

Tax increase for normalization violation. If, for any tax year ending after December 22, 2017, the taxpayer does not use a normalization method of accounting for the corporate rate reductions provided in the amendments made by Act Sec. 13001 of the 2017 Tax Cuts Act:

- the taxpayer's tax for the tax year is increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting, and
- the taxpayer is not treated as using a normalization method of accounting for purposes of Code Sec. 168(f)(2) and (i)(9)(C) (Act Sec. 13001(d)(4) of the 2017 Tax Cuts Act).

Effective date. The provision applies generally to tax years beginning after December 31, 2017 (Act Sec. 13001(c) of the Tax Cuts and Jobs Act). The provision relating to the withholding rules on disposition of U.S. real property applies to distributions made after December 31, 2017. The provision relating to the Code Sec. 1561 limitation on the use of the accumulated earnings credit by controlled corporate groups applies to transfers made after December 31, 2017 [applies to tax years beginning after December 31, 2017].

¶310 Alternative Minimum Tax (AMT) for Corporations

NEW LAW EXPLAINED

Corporate AMT repealed; minimum tax credit refundable in 2018 through 2021.—The alternative minimum tax (AMT) is repealed for corporations for tax years beginning after December 31, 2017 (Code Sec. 55(a), as amended by the Tax Cuts and Jobs Act). Thus, the AMT is only applicable to individuals, estates, and trusts after 2017.

COMMENT

The AMT exemption amounts and phaseout thresholds for individuals (but not estates and trusts) are temporarily increased beginning in 2018 (see ¶110). Partnership or S corporations are not subject to AMT, but instead a partner or S corporation shareholder computes AMT liability separately by taking into account their share of partnership or S corporation items.

A corporation's tentative minimum tax is zero ($0) for purposes of the minimum tax credit (AMT credit) beginning in 2018 (Code Sec. 53(d)(2), as amended by the 2017 Tax Cuts Act). As a result, a minimum tax credit claimed by a corporation beginning after 2017 is generally limited to the taxpayer's regular tax liability, reduced by other nonrefundable credits. The minimum tax credit is the corporation's AMT liability from tax years prior to its repeal and carried over to tax years after 2017 (Code Sec. 53(e), as added by the 2017 Tax Cuts Act). Any minimum tax credit carryover from a C corporation tax year may continue to offset the built-in gain tax of an S corporation for tax years beginning after December 31, 2021 (Code Sec. 1374(b)(3)(B), as amended by the 2017 Tax Cuts Act).

Any unused minimum tax credit is refundable for tax years beginning in 2018, 2019, 2020, and 2021 (Code Sec. 53(e), as added by the 2017 Tax Cuts Act). The refundable credit amount is equal to 50 percent (100 percent for tax years beginning in 2021) of the excess of the minimum tax credit for the tax year, over the amount allowable for the year against regular tax liability. Thus, the full amount of the minimum tax credit is allowed in tax years beginning before 2022. If a corporation has a short tax year, then the refundable credit amount for that year is prorated based on the number of days in the short year compared to 365 days.

Election to claim unused AMT credits in lieu of bonus depreciation. The annual election provided to corporations to claim unused minimum tax credits in place of bonus depreciation on property placed in service during the tax year of the election is repealed effective for tax years beginning after December 31, 2017 (Code Sec. 168(k)(4), stricken by the 2017 Tax Cuts Act).

General business credit and effect on other rules. Since corporate AMT is repealed, a corporation's tentative minimum tax is zero ($0) after 2017 for purposes of the tax liability limitation of the general business credit (Code Sec. 38(c)(6)(E), as added by the 2017 Tax Cuts Act). This means that a corporation may claim the credit to the extent it does not exceed 25 percent of its net regular tax liability above $25,000.

COMMENT

Since the corporate AMT is repealed, a corporation may forgo the election to amortize certain expenses to avoid any AMT adjustment or preference with regard to the expenses (circulation expenses, intangible drilling costs, and mineral exploration and development expenses) (Code Sec. 59(e)).

COMMENT

A net operating loss (NOL) deduction of a corporation from tax years beginning after 2017 is determined without regard to any AMT adjustments or preferences due to the repeal of the corporate AMT. Thus, an NOL carried back to determine the corporation's alternative minimum taxable income (AMTI) in tax years before 2018 is calculated the same as for regular tax liability.

Effective date. The amendments made by this section generally apply to tax years beginning after December 31, 2017 (Act Secs. 12001(c) and 12002(d)(1) of the Tax Cuts and Jobs Act). The amendment striking the minimum tax credit carryover of an S corporation arising in a tax year in which the corporation was a C corporation to offset the built-in gains tax of the S corporation applies to tax years beginning after December 31, 2021 (Act. Sec. 12002(d)(2) of the 2017 Tax Cuts Act).