Skadden

US Tax Reform Enacts the Most Comprehensive Changes in Three Decades

Contributing Partners

Brian Krause / New York

Sally A. Thurston / New York

Associate

Jay P. Cosel / New York

The sweeping tax bill that President Donald Trump signed into law on December 22, 2017, represents the most comprehensive reform of U.S. tax law since 1986. The law makes substantial changes to the taxation of individuals and business entities, including by lowering tax rates, modifying rules relating to the use of losses and deductions, and altering the taxation of U.S. multinationals' foreign operations.

The act lowers the corporate income tax rate from 35 percent to 21 percent; reducing it was a central issue for Republicans in Congress and the Trump administration. The law also makes broad changes to the corporate tax base, including imposing new rules limiting the deductibility of interest expense and temporarily permitting accelerated cost recovery of certain capital expenditures.

Meanwhile, the new rules for taxing U.S. multinationals' foreign profits reflect a shift from a "worldwide" system of taxation to a more territorial one, with corporations generally permitted to repatriate future profits of their foreign subsidiaries tax-free. However, many features of the current anti-deferral rules that subject certain foreign earnings to current U.S. taxation are retained. Moreover, a new set of rules will subject any foreign earnings in excess of a certain threshold to current U.S. taxation at a reduced rate. The result is perhaps more appropriately viewed as quasi-territoriality with a minimum tax rather than a true territorial system. The act also contains certain base erosion rules and incentives to bring operations onshore to the U.S. that could prove controversial under the U.S.'s General Agreement on Tariffs and Trade and tax treaties.

In addition, as part of a transition to the new system, the accumulated earnings of "controlled foreign corporations" and other foreign corporations owned 10 percent or more by a U.S. corporation that have not previously been subject to tax are deemed repatriated, and 10 percent U.S. shareholders (including individuals) of such foreign corporations will generally be subject to a one-time tax on their allocable share of such earnings. This tax is imposed at an effective 15.5 percent rate on accumulated earnings invested in cash or cash equivalents and an effective 8 percent rate on accumulated earnings in excess of the cash position.

The reform also makes important changes to the taxation of individuals. Key changes include reducing the top individual tax rate from 39.6 percent to 37.0 percent; subject to certain limitations, allowing individuals a deduction equal to 20 percent of their qualified business income (and certain other types of income) that is earned directly or through pass-through entities (such as partnerships and S corporations), resulting in a top tax rate of 29.6 percent; and limiting individuals' deductions for state and local income and property taxes to $10,000 per year.

In many cases, there is significant uncertainty around the scope and application of the act's provisions. Members of Congress have already noted the need for a technical corrections bill, and significant regulatory guidance from the Treasury and the Internal Revenue Service also is expected.

For more on the tax reform, see our January 18, 2018, client alert "An In-Depth Look at the Impact of US Tax Reform on Mergers and Acquisitions."

This article is from Skadden's *2018 Insights*.

Four Times Square
New York, NY 10036
212.735.3000