



Power and utility industry measures in new tax law

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Introduction

The president on December 22, 2017, signed into law H.R. 1, originally known as the “Tax Cuts and Jobs Act.” The new law represents the culmination of a lengthy process in pursuit of business tax reform over the course of more than 20 years.

The legislation includes substantial changes to the taxation of individuals as well as U.S. businesses, multi-national enterprises, and other types of taxpayers. Overall, it provides a net tax reduction of approximately \$1.456 trillion over the 10-year “budget window” (according to estimates provided by the Joint Committee on Taxation (JCT) that do not take into account macroeconomic/dynamic effects). Highlights of provisions that impact the power and utility industry include:

- A permanent reduction in the statutory C corporation tax rate to 21% with statutory provisions requiring that excess tax reserves associated with public utility property be normalized
- Repeal of the corporate alternative minimum tax (AMT)
- Expensing of capital investment with an exception for property predominantly used in certain rate regulated trade or businesses
- Limitation of the deduction for interest expense with an exception for interest expense properly allocable to certain rate regulated trade or businesses
- Modification to the capital contribution rules under section 118
- Fundamental changes to the taxation of multinational entities, including a shift from the current system of worldwide taxation with deferral to a hybrid territorial system, featuring a participation exemption regime with current taxation of certain foreign income, a minimum tax on low-taxed foreign earnings, and new measures to deter base erosion and promote U.S. production

The following discussion provides initial analysis and observations regarding the tax law changes in H.R. 1 that are considered to be of greatest importance for the power and utility industry.

Read a 167-page report prepared by KPMG that examines the provisions in the new tax law and provides observations: [New tax law \(H.R. 1\) – Initial observations](#) [PDF 1.4 MB]

Documents

- Read text of the tax bill, [H.R. 1](#) [PDF 491 KB] (185 pages)
- The [conference agreement](#) [PDF 4.25 MB] (1097 pages) includes (1) bill language, (2) an explanatory statement, and (3) a preliminary revenue table prepared by the staff of the Joint Committee on Taxation (JCT).
- Read the [CBO cost estimate](#) for the conference agreement on H.R. 1.
- The JCT provided estimates of the budget effects of the conference agreement on H.R. 1. Read [JCX-67-17](#)
- Read [JCX-68-17](#) (Distributional Effects of the Conference Agreement for H.R. 1)
- Read [JCX-69-17](#) (Macroeconomic Analysis of the Conference Agreement for H.R. 1)

Reductions in corporate tax rate and dividends received deduction

The new law eliminates the progressive corporate tax rate structure, currently imposing a maximum corporate tax rate of 35%, and replaces it with a flat tax rate of 21% (and makes various corresponding changes throughout the Code). The new rate is effective for tax years beginning after 2017. In addition, the new law lowers the 80% dividends received deduction (for dividends from 20% owned corporations) to 65% and the 70% dividends received deduction (for dividends from less than 20% owned corporations) to 50%, effective for tax years beginning after 2017.

The new law also repeals the alternative corporate tax on net capital gain (prior law Code section 1201).

The JCT has estimated that the rate reduction will decrease revenues by approximately \$1.35 trillion over 10 years.

KPMG observation

This reduction is intended to make the U.S. corporate tax rate more competitive with the rates imposed by other countries. Consistent with the overall theme of the new law, this provision lowers tax rates in exchange for the elimination of certain tax benefits.

Section 15 generally results in the application of a “blended” tax rate for tax years of fiscal year taxpayers that include the effective date of the rate change (December 31, 2017).

The new law’s 21% corporate tax rate is slightly higher than the 20% rate proposed in the House and Senate bills. The effective date of the change is the same as in the House bill, but reflects a one-year acceleration from the effective date provided by the Senate bill.

The House and Senate bills had modified the dividends received deduction to provide parity between the marginal tax rate on dividends received by corporations (1) under current law and (2) at a 20% rate. The new law does not further adjust the dividends received deduction to reflect the increase in the corporate rate to 21%.

The corporate rate under the new law is substantially below the top individual tax rate (37%), which re-establishes the relationship between these tax rates that was in place beginning with the enactment of the Revenue Act of 1913 until the enactment of the Tax Reform Act of 1986.

Excess deferred taxes for public utility property

As part of the corporate rate reduction, the new law provides that a normalization method of accounting is used for excess tax reserves associated with public utility property. Consistent with the Tax Reform Act of 1986, the measure would provide for the use of the average rate assumption method (ARAM) for the determination of the timing of the return of excess deferred taxes. However, the new law also allows for an alternative method if the books and underlying records do not contain the vintage account data necessary to apply ARAM. A new provision is added to address a violation of the normalization requirement. A violation would result in an increase in tax by the amount by which the taxpayer reduces its excess deferred tax reserve more rapidly than permitted under the normalized method of accounting. The final statute differed from the House bill by adding that a violation of the normalization requirement for excess deferred taxes not only results in the aforementioned penalty but is also considered a violation under existing rules. Therefore, there is a loss of the use of accelerated depreciation and a cash penalty.

The conference committee report includes the following discussion and example of ARAM:

The average rate assumption method reduces the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes during the years in which the deferred tax reserve related to such property is reversing. Under this method, the excess tax reserve is reduced as the timing differences (i.e., differences between tax depreciation and regulatory depreciation with respect to the property) reverse over the remaining life of the asset. 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. 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 which reverses during a taxable 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.

The following example illustrates the application of the average rate assumption method. 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% declining balance method and a half-year placed in service convention.

Normalization calculation for corporate rate reduction (Millions of dollars)

	Year(s)										
	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>Total</u>
Tax expense	20	32	19.2	11.52	11.52	5.76	0	0	0	0	100
Book depreciation	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>10</u>	<u>100</u>
Timing difference	10	22	9.2	1.52	1.52	(4.24)	(10)	(10)	(10)	(10)	0
Tax rate	<u>35%</u>	<u>35%</u>	<u>21%</u>	<u>21%</u>	<u>21%</u>	<u>31.1%</u>	<u>31.1%</u>	<u>31.1%</u>	<u>31.1%</u>	<u>31.1%</u>	
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 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						<u>(1.3)</u>	<u>(3.1)</u>	<u>(3.1)</u>	<u>(3.1)</u>	<u>(3.1)</u>	<u>(13.8)</u>
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 taxpayer will begin taking the excess tax reserve into account in the 2021 taxable 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 taxable years is multiplied by 31.1% 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).

Limitation on the deduction of net business interest expense

The new law amends section 163(j) to disallow a deduction for net business interest expense of any taxpayer in excess of 30% of a business's adjusted taxable income plus floor plan financing interest. The explanatory statement indicates that the section 163(j) limitation should be applied after other interest disallowance, deferral, capitalization or other limitation provisions. Thus, the provision would apply to interest deductions that are deferred in the tax year in which such deductions are deferred, capitalized, or disallowed.

The new limitation does not apply to business interest expense that is properly allocable to the trade or business of furnishing or selling electrical energy, water or sewage disposal services, gas or steam through a local distribution system, or transportation of gas or

steam by pipeline if the rates for such furnishing or sale are subject to rate regulation or by the governing or ratemaking body of an electric cooperative

KPMG observation

It is unclear how to determine what is “properly allocable to a trade or business”. Business interest not properly allocable to the delineated regulated businesses would be subject to potential disallowance.

Adjusted taxable income generally is a business’s taxable income computed without regard to: (1) any item of interest, gain, deduction, or loss that is not properly allocable to a trade or business; (2) business interest or business interest income; (3) the amount of any net operating loss deduction; (4) the 20% deduction for certain passthrough income, and (5) in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion. The new law permits the Treasury Secretary to provide other adjustments to the computation of adjusted taxable income. A business’s adjusted taxable income may not be less than zero for purposes of the limitation.

Business interest is defined as any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for tax purposes is treated as “interest” for purposes of this provision. The term “business interest” does not include investment interest within the meaning of section 163(d).

Subject to the exclusions or those businesses that may elect out, the provision applies to all businesses, regardless of form, and any disallowance or excess limitation would generally be determined at the filer level (e.g., at the partnership level instead of the partner level). For a group of affiliated corporations that join in filing a consolidated return, the conference report’s explanatory statement says that the provision applies at the consolidated tax return filing level, although the provision itself does not address this point. Subject to the special rules for partnerships, any business interest disallowed would be carried forward indefinitely. Carryover amounts are taken into account in the case of certain corporate acquisitions described in section 381 and are subject to limitation under section 382.

Special carryforward rules, described below, apply to partners in the case of business interest not allowed as a deduction to a partnership.

The new law prevents a partner from double counting a partnership’s adjusted taxable income when determining the partner’s business interest limitation. More specifically, a partner’s adjusted taxable income is determined without regard to the partner’s distributive share of the partnership’s items of income, gain, deduction, or loss.

The explanatory statement illustrates the double counting rule with the following example.

ABC is a partnership owned 50-50 by XYZ Corporation and an individual. ABC generates \$200 of noninterest income. Its only expense is \$60 of business interest.

Under the provision, the deduction for business interest is limited to 30% of adjusted taxable income, that is, $30\% \times \$200 = \60 . ABC deducts \$60 of business interest and reports ordinary business income of \$140. XYZ's distributive share of the ordinary business income of ABC is \$70. XYZ has net taxable income of zero from its other operations, none of which is attributable to interest income and without regard to its business interest expense. XYZ has business interest expense of \$25. In the absence of a double counting rule, the \$70 of taxable income from XYZ's distributive share of ABC's income would permit XYZ to deduct up to an additional \$21 of interest ($30\% \times \$70 = \21), and XYZ's \$100 share of ABC's adjusted taxable income would generate \$51 of interest deductions, well in excess of the intended 30% limitation. If XYZ were a passthrough entity rather than a corporation, additional deductions might be available to its partners as well, and so on.

The double counting rule prevents this result by providing that XYZ has adjusted taxable income computed without regard to the \$70 distributive share of the nonseparately stated income of ABC. As a result, it has adjusted taxable income of \$0. XYZ's deduction for business interest is limited to $30\% \times \$0 = \0 , resulting in a deduction disallowance of \$25.

The new law allows a partner to use its distributive share of any excess (i.e., unused) taxable income limitation of the partnership or in computing the partner's business interest limitation. The excess taxable income with respect to any partnership is the amount that bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30% of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership exceeds the business interest income of the partnership bears to 30% of the adjusted taxable income of the partnership. Any such excess adjusted taxable income is allocated in the same manner as nonseparately stated income and loss.

The explanatory statement provides the following example.

*Assume the partnership described above had only \$40 of business interest. ABC has a limit on its interest deduction of \$60. The excess of this limit over the business interest of the partnership is $\$60 - \$40 = \$20$. The excess taxable income for ABC is $\$20 / \$60 * \$200 = \66.67 . XYZ's distributive share of the excess taxable income from ABC partnership is \$33.33. XYZ's deduction for business interest is limited to 30% of the sum of its adjusted taxable income plus its distributive share of the excess taxable income from ABC partnership ($30\% * (\$0 + \$33.33) = \$10$). As a result of the rule, XYZ may deduct \$10 of business interest and has an interest deduction disallowance of \$15.*

As noted earlier, special carryforward rules apply to partners and partnership. Excess business interest of a partnership is not treated as paid or accrued by the partnership in the succeeding tax year. Instead excess business interest is allocated to each partner in the same manner as the nonseparately stated taxable income or loss of the partnership.

Excess business interest allocated to a partner is treated as business interest paid or accrued by the partner in the next succeeding tax year in which the partner is allocated excess taxable income from the partnership but only to the extent of such excess taxable income. Any remaining excess business interest can be carried forward by the partner and deducted subject to the excess taxable income limitation. A partner's adjusted basis in its partnership interest is reduced (but not below zero) by the amount of excess business interest allocated to the partner. If a partner disposes of its partnership interest, including in a non-recognition transaction, the partner's basis in the interest is increased, immediately prior to the disposition, by the excess of: (i) the amount basis was reduced as described above over (ii) the amount of excess business interest allocated to the partner and treated as paid or accrued in a succeeding tax year.

The provision is effective for tax years beginning after 2017.

The JCT has estimated the provision will increase revenues by approximately \$253.4 billion over 10 years.

KPMG observation

Under the new law, any net interest disallowance applies at the filer level rather than the taxpayer level. Thus, the determination is made at the partnership rather than the partner level. This affects not only the determination of any interest disallowance, but also any excess amount (i.e., interest expense capacity) passed through from a partnership to its partners. There may also be uncertainties created when applying the rules at the partnership level when references are made to the rules of section 469 which apply at the partner level.

Special rules allow a partnership's unused interest limitation for the year to be used by its partners and to ensure that net income from the passthrough entity are not double counted at the partner level. With respect to the double-counting rule, the new law excludes a partner's distributive share of all partnership items.

The new law permits interest disallowed at the partnership level to be passed through to the partners and deducted in succeeding tax years in which, and to the extent that, the partners are allocated excess taxable income from such partnership. The new law also provides for adjustments to the partners' bases in partnership interests to account for disallowed interest that is passed through.

The new provision applies only to business interest expense of the taxpayer. Nonbusiness interest, such as investment interest expense, continues to be subject to the limitation on investment interest. In addition, payments that are not interest such as capitalized debt costs that are amortized like OID under Reg. section 1.446-5 are not included.

The provision includes only taxable interest income in the computation of net business interest expense. Thus, investments in tax-free municipal bonds do not increase a taxpayer's interest expense capacity.

While the new law does not explicitly indicate how the new rule interacts with other interest disallowance and deferral provisions, the explanatory statement indicates that the provision is intended to apply after other interest disallowance and deferral provisions.

In addition, there appear to be no special rules for financial services entities. As a result, the determination of net business interest expense is unclear for a company like an insurer that generates significant interest income related to investments as an integral part of its active insurance business.

It should be noted that interest expense can occur as a result of repurchasing one's debt instrument at a premium. Under Reg. section 1.163-7(c), if a borrower repurchases its debt instrument for an amount in excess of its adjusted issue price, the repurchase premium is deductible as interest for the tax year in which the repurchase occurs, unless the deduction for the repurchase premium is disallowed under section 249 or the repurchase premium was the result of certain debt-for-debt exchanges.

Finally, the new provision does not address what happens to a corporation's existing disallowed interest expense for which a deduction was not claimed because of existing section 163(j). Thus, it is unclear if Congress intends that a corporation may treat that disallowed interest expense as business interest paid or accrued in a year after the effective date of the provision.

Cost recovery

Temporary 100% expensing for certain business assets

The new law extends and modifies the additional first-year depreciation deduction ("bonus depreciation").

Under the new law, generally, the bonus depreciation percentage is increased from 50% to 100% for property acquired and placed in service after September 27, 2017, and before 2023. It also provides a phase down of the bonus depreciation percentage, allowing an 80% deduction for property placed in service in 2023, a 60% deduction for property placed in service in 2024, a 40% deduction for property placed in service in 2025, and a 20% deduction for property placed in service in 2026. These same percentages apply to specified plants planted or grafted after September 27, 2017, and before 2027. Longer production period property and certain aircraft get an additional year to be placed in service at each rate.

Property that is acquired prior to September 28, 2017, but placed in service after September 27, 2017, remains subject to the bonus depreciation percentages available under current law—i.e., 50% for property placed in service in 2017, 40% for property placed in service in 2018, and 30% for property placed in service in 2019. Under the new law, the acquisition date for property acquired pursuant to a written binding contract is the date of such contract.

KPMG observation

Prior legislation, and IRS regulations issued in 2003 interpreting such legislation, provided specific rules for determining the acquisition date of self-constructed property for bonus depreciation purposes. The new law, however, is silent as to the determination of the acquisition date for self-constructed property. Thus, it is unclear whether prior law standards will be used for acquisition date determinations for self-constructed property under the new rules.

The new law changes the definition of qualified property (i.e., property eligible for bonus depreciation) by including used property acquired by purchase so long as the acquiring taxpayer has not previously used the acquired property and so long as the property is not acquired from a related party.

In addition, the new law excludes any property used in providing certain utility services if the rates for furnishing those services are subject to ratemaking by a government entity or instrumentality or by a public utility commission.

KPMG observation

As in the House and Senate bills, the new law excludes from bonus-eligible qualified property any property used in trades or businesses that is not subject to the limitation of net business interest expense under section 163(j).

The change in the definition of qualified property could have an important effect on M&A transactions. It increases the incentive for buyers to structure taxable acquisitions as actual or deemed (e.g., pursuant to section 338) asset purchases, rather than stock acquisitions, by enabling the purchasing entity in an asset acquisition to immediately deduct a significant component of the purchase price, and potentially to generate net operating losses in the year of acquisition that could be carried forward (subject, in general, to an 80% of taxable income limitation as described elsewhere in this document) to shield future income.

In the case of a taxpayer's first tax year ending after September 27, 2017, the new law permits the taxpayer to elect to apply a 50% allowance in lieu of 100%.

The JCT has estimated that the provision will decrease revenues by approximately \$86.3 billion over 10 years.

KPMG observation

The new law incorporates the most favorable provisions of both the House and Senate bills by expanding the availability of bonus depreciation to purchased non-original use property, and by instituting a four-year phase down period from 2023 through 2026.

Corporate AMT

The new law repeals the corporate AMT effective for tax years beginning after December 31, 2017. Any AMT credit carryovers to tax years after that date generally may be utilized to the extent of the taxpayer's regular tax liability (as reduced by certain other credits). In addition, for tax years beginning in 2018, 2019, and 2020, to the extent that AMT credit carryovers exceed regular tax liability (as reduced by certain other credits), 50% of the excess AMT credit carryovers are refundable (there is a proration rule with respect to short tax years). Any remaining AMT credits will be fully refundable in 2021.

The JCT has estimated that the repeal of the corporate AMT will reduce revenues by approximately \$40.3 billion over a 10-year period.

KPMG observation

Repealing the corporate AMT eliminates some of the complexity inherent in U.S. corporate taxation. For taxpayers with significant corporate AMT credit carryovers, the new law allows the full use of the credits to (i) reduce or eliminate regular tax liability, and (ii) obtain tax refunds to the extent the AMT credit carryovers exceed regular tax liability.

While the new law repeals the AMT, it also generally limits the NOL deduction for a given year to 80% of taxable income, adding a more restrictive version of the 90% limitation that previously existed only in the AMT regime. As shorthand, the 90% limitation in the AMT regime can be viewed as imposing a 2% tax rate (20% AMT rate multiplied by the 10% of income that cannot be offset with an NOL deduction). This "shorthand" rate is 4.2% under the new law (21% corporate tax multiplied by the 20% of income that cannot be offset with NOLs).

The repeal of the corporate AMT in the new law is consistent with the House bill but represents a change from the Senate bill, which would have retained the corporate AMT. The Senate bill's preservation of the corporate AMT, when combined with its 20% corporate tax rate, would have increased the number of corporations subject to the AMT and would have resulted in significant collateral consequences and additional complexity.

Natural resources

Taxpayers other than corporations continue to be subject to the AMT and may need to make adjustments for mine exploration and development costs (section 56(a)(2)(A)); mine depletion (sections 56(g)(F)(i) and 57(a)(1)); and the oil and gas and geothermal intangible drilling and development costs preference (section 57(a)(2)). Section 59(f) (which coordinates section 59(e) with section 291) is repealed by the new law. It appears that Congress did not expect corporations to use section 59(e) after 2017. A corporation with domestic NOLs and foreign source income covered by foreign tax credits may want to consider using section 59(e) to eliminate the domestic NOL.

Modified net operating loss (NOL) deduction

The new law limits the NOL deduction for a given year to 80% of taxable income, effective with respect to losses arising in tax years beginning after December 31, 2017. This limitation is similar to, although more restrictive than, the current 90% limitation for NOLs in the corporate AMT regime (which, as indicated above, is repealed by the new law).

The new law also repeals the current carryback provisions for NOLs; the statutory language indicates that this provision applies to NOLs arising in tax years ending after December 31, 2017, although it permits a new two-year carryback for certain farming losses and retains present law for NOLs of property and casualty insurance companies. Prior law generally provided a two-year carryback and 20-year carryforward for NOLs, as well as certain carryback rules for specific categories of losses (e.g., “specified liability losses” may be carried back 10 years). The repeal of the existing carryback provisions includes the repeal of the carryback limitations applicable to corporate equity reduction transactions (CERTs). The CERT rules are intended to prevent corporations from financing leveraged acquisitions or distributions with tax refunds generated by the carryback of interest deductions resulting from the added leverage. If applicable, the CERT rules can limit the amount of a NOL that can be carried to tax years preceding the year of the CERT.

The statutory language of the new law provides for the indefinite carryforward of NOLs arising in tax years ending after December 31, 2017, as opposed to the current 20-year carryforward.

The JCT has estimated that the provision will increase revenue by approximately \$201.1 billion over 10 years (approximately \$45 billion more than the estimates for each of the House and Senate proposals).

KPMG observation

The new law does not appear to limit the three-year capital loss carryback allowed for corporations or impose a limitation on the utilization of capital loss carryovers.

The new law requires corporations to track NOLs arising in tax years beginning (1) on or before December 31, 2017, and (2) after December 31, 2017, separately, as only the latter category of NOLs would be subject to the 80% limitation.

The 80% limitation applies to losses arising in tax years beginning after December 31, 2017, whereas the statutory language regarding the indefinite carryover and the elimination (for most taxpayers) of the NOL carryback applies to losses arising in tax years ending after December 31, 2017. Accordingly, the NOLs of fiscal year taxpayers arising in tax years that begin before December 31, 2017 and end after December 31, 2017 would not be subject to the 80% limitation but (for most taxpayers) may not be carried back and may be carried forward indefinitely. In addition, the conference report’s explanatory statement describes the effective date for the indefinite carryover and

modification of carrybacks differently, indicating that the provision applies to losses arising in tax years beginning after December 31, 2017.

The changes to the NOL carryover provisions possibly may have a significant effect on the financial statement treatment of loss carryovers incurred in future tax years, given that unused loss carryovers no longer will expire. In addition, the potential 80% limitation on post-2017 NOLs and the elimination of post-2017 NOL carrybacks, combined with the reduction of the corporate tax rate, provides corporations with a significant incentive to accelerate deductions into 2017 and to defer income into 2018. In general, taxpayers may find it beneficial to stagger purchases as long as full expensing is available, or selectively elect out of full expensing for property in one or more depreciation recovery classes during this period, if doing so would avoid creating or increasing NOLs subject to the 80% limitation.

The NOL changes also remove the counter-cyclical effect of loss carrybacks in that corporations generating losses due to a business downturn or due to large environmental or product liability payments no longer will be able to carry back losses to obtain refunds of taxes paid in prior years.

The new law does not include a formula to increase NOL carryforwards by an interest factor over time, as was provided in the House bill.

Revisions to treatment of capital contributions

The new law modifies section 118, which provides an exclusion from gross income for contributions to the capital of a corporation. Specifically, the new law excludes from section 118 any “contribution in aid of construction” (CIAC) or any other contribution as a customer or potential customer, as well as any contribution by any government entity or civic group (other than a contribution made by a shareholder as such). The previous exception under section 118(c) for CIAC’s received by water and sewerage disposal utilities has been repealed. This provision applies to contributions made after the date of enactment, unless the contribution is made by a government entity pursuant to a master development plan that is approved prior to the effective date by a government entity.

The JCT has estimated that the provision will increase revenue by approximately \$6.5 billion over 10 years.

KPMG observation

The new law’s modifications to section 118 generally require corporations to include the specified types of contributions in gross income.

The new law significantly modifies the corresponding provision in the House bill (the Senate bill did not include a similar provision), which would have repealed Code sections 118 (that provides for nonrecognition by a corporation on the receipt of a contribution to

capital) and 108(e)(6) (that harmonizes the discharge of indebtedness income rules with section 118) and enacted new Code section 76 (that affirmatively would have required corporations and partnerships to recognize income on the receipt of a contribution to capital). The report on the House bill indicated that these changes were intended to eliminate a federal tax subsidy for state and local incentives and concessions granted to corporations to incentivize them to locate operations within the grantor's jurisdiction. However, the changes in the House bill would have applied to a much broader range of situations than suggested by the policy description and would have created a number of apparently unintended and unexpected consequences, including a particularly destabilizing impact on workouts and efforts to rehabilitate troubled companies.

The summary explanation notes that the new law follows the policy of the House bill, but takes a different approach. The new law eliminates the House bill's specific section 76 recognition provision and limits section 118 nonrecognition in a manner consistent with the policy justification given for the House bill. This approach avoids many of the problematic and uncertain consequences raised by the House bill. See "Critique of House's Treatment of Capital Contributions," Tax Notes, Dec. 11, 2017, p. 1641.

The summary explanation also notes that the conferees, consistent with the IRS current view, intend that section 118, as modified, continue to apply only to corporations.

Repeal deduction for income attributable to domestic production activities

Under the new law, the deduction for domestic production activities provided under section 199 is repealed for tax years beginning after December 31, 2017.

JCT has estimated that repealing section 199 will increase revenues by approximately \$98 billion from 2018-2027.

KPMG observation

Congress's intent in enacting section 199 was to provide a targeted corporate rate reduction that would allow U.S. companies to compete against international tax systems, while also drawing international companies to the United States and its tax structure. While the new law eliminates the rate reduction created by section 199, a separate provision of the legislation effects a much larger overall corporate rate reduction, as discussed above.

The repeal of section 199 applies to tax years beginning after December 31, 2017, so fiscal year taxpayers would still be able to claim the section 199 deduction for fiscal years ending after December 31, 2017, but beginning before the repeal date. In addition, as discussed above, special rules apply to corporate taxpayers whose tax years straddle the effective date. The rules under section 15 generally result in application of a blended corporate rate to taxable income for the year that straddles the effective date. As a result, fiscal year taxpayers would be eligible for the section 199 deduction as well as partial

impact of the 21% corporate tax rate for tax years beginning before January 1, 2018, and ending after December 31, 2017.

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