President Trump signs tax reform bill with significant impacts to mining companies

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In brief

President Donald Trump on December 22 signed HR 1 (the Conference Agreement), a far-reaching bill that will have significant impact on the mining sector. (For prior coverage, see PwC Insight, 'House and Senate tax reform proposals could significantly impact mining companies,' December 14, 2017.)

This PwC Insight summarizes select business and international tax provisions in the Conference Agreement that could have a significant impact on mining companies.

In detail

Business proposals

Corporate income tax rate

In a change from the House and Senate bills, each of which would have reduced the corporate income tax rate to 20 percent from the current 35-percent top rate, the Conference Agreement reduces the rate to 21 percent, effective for tax years beginning after December 31, 2017.

Observation: Companies in the mining industry generally are expected to benefit from the lower corporate tax rate of 21 percent, which combined with the state effective tax rate puts US-based companies closer to the average OECD rate. The lower rate also may make foreign investments in the United States potentially more attractive.

Alternative minimum tax (AMT)

The Conference Agreement repeals the corporate AMT, effective for tax years beginning after December 31, 2017.

The Conference Agreement provides that taxpayers with AMT credit carryforwards may claim a refund of 50 percent of the remaining credits (to the extent the credits exceed regular tax for the year) in tax years beginning in 2018, 2019, and 2020. Taxpayers may then claim a refund for all AMT credit carryforwards remaining after 2020 in the tax year beginning in 2021.

Observation: Historically, many mining companies have paid AMT due primarily to significant AMT preference items for percentage depletion deductions in excess of basis as well as differences in recovery of capital expenditures, exploration, and development costs. The Conference Agreement's repeal of AMT and monetization of existing AMT credits is a welcome simplification for the industry.

Full expensing of capital expenditures

The Conference Agreement allows taxpayers to immediately expense the entire cost of depreciable assets placed in service after September 27, 2017, and before January 1, 2023 (i.e., 100 percent bonus depreciation).

The amount of bonus depreciation then will be phased out by 20 percentage points per calendar year. The Conference Agreement retains the provision from the House bill allowing full expensing of used assets.

Observation: The mining sector is capital-intensive, so cost recovery generally is important. By providing bonus depreciation for an extended period of time, the Conference Agreement allows companies to achieve certainty for cost recovery for capital expenditures for a relatively significant period of time, which in turn helps companies in these industries better assess the cash costs of their investments.

State tax observation: Since many states already decouple from or modify Section 168(k), we expect continued nonconformity in this area. Given the potential magnitude of the cost to states of conforming to Section 168(k), additional states may enact legislation to decouple from the provision. Nonconformity raises many state issues, including the inability of taxpayers to elect 50-percent bonus in lieu of 100-percent bonus for state purposes, federal and state basis discrepancies, modifications required in computing state taxable income, and the financial statement implications associated with the potential book-tax differences from a state income tax perspective. Taxpayers should examine how states conform to or decouple from other provisions under Section 168, such as shortened recovery periods and full expensing for used property.

Section 199

The Conference Agreement repeals the Section 199 deduction for domestic production activities, effective for tax years beginning after December 31, 2017.

Interest expense limitations

The Conference Agreement applies a net interest expense limitation equal to 30 percent of earnings before interest, taxes, depreciation, and amortization (EBITDA) for tax years beginning after December 31, 2017, and before January 1, 2022, after which the net interest expense limitation is calculated as 30 percent of EBIT. Any disallowed interest may be carried forward indefinitely. The transition from EBITDA to EBIT coincides with the date on which the 100-percent bonus depreciation provision begins to phase out.

Special rules apply to determine a partner's interest limitation with respect to investments in partnerships.

The Conference Agreement does not include the worldwide leverage test (Section 163(n)) from the Senate bill.

Observation: Many companies in the mining sector will be negatively affected by the limitations on interest deductions as they evaluate the cost of borrowing to fund capital expenditures or other acquisitions. Despite the indefinite carryforward, companies will need to consider whether a valuation allowance applies to any interest deductions carried over to future years.

State tax observation: States with rolling conformity or that start with federal taxable income would conform automatically to the new Section 163(j) limitation. The limitation may have to be determined on a separate-company basis, even in certain combined and consolidated reporting states, since the limitation would be applied to 'the taxpayer,' a term that states have used to refer to separate corporations, even within a filing group. Even if a state generally conforms to the disallowed interest carryover provisions, it may alter the carryover period similar to its treatment of net operating loss carryovers,. A state that conforms to the carryover provisions would need to enact rules to determine whether the carryover would be applied on a pre- or post-apportionment basis.

Net operating losses (NOLs)

The Conference Agreement limits a taxpayer's ability to utilize its NOL deduction to 80 percent of taxable income (determined without regard to the deduction), for losses arising in tax years beginning after December 31, 2017. The Conference Agreement generally eliminates the carryback of all NOLs — including the specified liability loss 10-year carryback — and instead permits all such NOLs to be carried forward indefinitely. These changes would be effective for NOLs generated in tax years beginning after December 31, 2017. NOLs generated in earlier tax years would maintain their treatment under current law.

Observation: Current tax law provides for a carry-back (up to 10 years) for specified liability losses described in Section 172(f), such as reclamation of land and environmental remediation. While the Conference Agreement repeals all carrybacks for losses arising in tax years beginning after 2017, mining companies should give consideration as to whether or not specified liability losses can be carried back from 2017, before the repeal of the NOL carryback period.

State tax observation: Most state NOL rules differ from federal NOL rules, with a few exceptions, such as Delaware, Missouri, and Virginia. States that conform to federal NOL provisions generally, and carryforward periods in particular, may need to address the ramifications of the Conference Agreement.

Like-kind exchanges

The Conference Agreement limits like-kind exchanges to real property not held for sale, effective generally for exchanges completed after December 31, 2017.

Tax year of inclusion

The Conference Agreement codifies Revenue Procedure 2004-34 for advance payments of goods and services by limiting the deferral of income to the next tax year to the extent the income has not been recognized in the taxpayer's financial statements, effective for tax years beginning after December 31, 2017.

International proposals

Repatriation

The Conference Agreement changes the current US 'worldwide' international tax system to a 'territorial' tax system by means of a 100-percent dividends received deduction (DRD). The Conference Agreement imposes a transitional one-time 'toll charge' of 15.5 percent on cash and cash equivalents and eight percent on illiquid assets. The Conference Agreement also includes significant anti-base-erosion measures.

State tax observation: While many states provide some level of deduction for domestic and foreign dividends (including Subpart F income) in computing taxable income, not all states provide such a deduction. The impact for each state of including deferred foreign earnings under the Conference Agreement will depend in part on whether the state automatically conforms to Section 965 (or subsequently adopts the revisions to Section 965). For a state that conforms, taxpayers will need to consider whether the state also will follow the Section 965 partial deduction from the gross inclusion, and how the state DRD or elimination provisions may apply. In addition, for those states that do not automatically conform, taxpayers still may need to consider the state tax impact of any eventual distributions, and those determinations may differ in each such state. Finally, unlike the federal provisions, it is unlikely that states would provide taxpayers the option to pay the Section 965 toll charge over multiple years.

Global intangible low-taxed income (GILTI) and deductions and foreign derived intangible income (FDII) deduction

The Conference Agreement requires current-year inclusion of certain GILTI by US shareholders of its controlled foreign corporations in a manner similar to subpart F income inclusions. The provision allows an 80-percent FTC and a 50-percent deduction for such low-taxed income. The new provision provides a 37.5-percent deduction (through 2025 and then a 21.875-percent deduction for taxable years beginning after December 31, 2025) for certain foreign-derived intangible income derived from a US trade or business.

This provision is effective for tax years of foreign corporations beginning after December 31, 2017, and tax years of US shareholders in which or with which such tax years of foreign corporations end.

Observation: FDII is intended to represent a domestic corporation's income in excess of a routine return, determined on a formulaic basis, that is derived from serving foreign markets. When the deductions for FDII and GILTI are combined with the tax imposed under the GILTI provision, the effect is to subject domestic corporations to tax at a reduced rate on net income in excess of a routine return derived in connection with sales to, or services performed for, foreign customers, whether that income is earned by the corporation or its controlled foreign corporations. These new provisions should be reviewed for applicability to mining companies selling minerals produced in the United States to foreign customers.

State tax observation: State application of the income inclusion mechanism under new Section 951A will not necessarily coincide with the deductions under new Section 250, and vice versa. Moreover, beyond conformity to the two sections, differences among state filing entities and groups could create additional mismatches among different related US entities and/or different states.

'Base erosion and anti-abuse' tax on certain inbound 'base erosion payments' (BEAT)

The Conference Agreement imposes a new tax known as the 'base erosion and anti-abuse' tax or BEAT on certain inbound 'base erosion payments.' Companies subject to the tax pay the excess of tax computed at a 10-percent rate (5-percent rate for one year in the taxable year beginning after December 31, 2017) on an expanded definition of taxable income over their regular tax liability reduced by certain credits. In 2026 and thereafter, the BEAT would increase to 12.5 percent and would not be offset by any credits.

The tax applies to a taxpayer, which is a corporation (other than a regulated investment company, a real estate investment trust, or an S corporation) with average annual gross receipts for the three-taxable-year period ending with the preceding taxable year of at least $500 million, and that make certain base-eroding payments to related foreign persons for the taxable year of three percent or higher of total deductible expenses, with certain exceptions.

The BEAT applies to amounts paid or accrued in tax years beginning after December 31, 2017.

Separate foreign tax credit limitation basket for foreign branch income

The Conference Agreement adds a new foreign tax credit basket for 'foreign branch income,' which is defined as the business profits of a US person attributable to one or more qualified business units (QBUs).

Observation: It is not clear whether this limitation is to be applied on a QBU-by-QBU basis or on an aggregate QBU basis.

This provision is effective for tax years beginning after December 31, 2017.

Sale of partnership interests

The Conference Agreement treats gain or loss from the sale or exchange of a partnership interest as income that is effectively connected with a US trade or business (ECI) to the extent the transferor would have had ECI if the partnership had sold all its assets at fair market value on the date of sale.

This provision effectively codifies the result in Revenue Ruling 91-32, which the Tax Court recently declined to follow in Grecian Magnesite Mining.

Under this provision, the transferee of a partnership interest must withhold 10 percent of the amount realized on the sale or exchange of the partnership interest if any portion of the gain is ECI. This provision applies to sales of interests in publicly traded partnerships, such as MLPs.

The portion of the provision treating gain or loss on sale of a partnership interest as ECI is effective for sales, exchanges, and dispositions on or after November 27, 2017. The portion of the provision requiring withholding on sales or exchanges of partnership interests is effective for sales, exchanges, and dispositions after December 31, 2017.

The takeaway

The Conference Agreement on tax reform legislation includes numerous provisions of potential importance to companies in the mining sector.

Taxpayers in the sector should study these provisions carefully, especially those with immediate effect, and consider both the opportunities and negative effects this far-reaching legislation could present. Some provisions may require taxpayers to take action quickly, including addressing the financial statement implications of this change in tax law, and to consider how best to structure their operations going forward.

For more information on the Conference Agreement

- HR 1 final text as passed
- Conference Committee report
- JCT staff revenue score

Of further interest

- Visit our Policy on the move website to understand how policy change could impact your business
- Get your free trial of Inside Tax Policy, our on-demand video platform to keep up with policy changes as they unfold.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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