By **Daniel R. Van Vleet**

Business Valuation and the New Tax Law

Significant impact on the absolute and relative values of C corporations and pass-through entities

On Dec. 22, 2017, President Donald J. Trump signed into law the Tax Cuts and Jobs Act (the Act). The Act is the most comprehensive tax reform package since the Tax Reform Act of 1986. It contains sweeping changes to corporate and individual tax rates, deduction limitations, foreign earnings taxation and the tax treatment of pass-through entities (PTEs) such as S corporations (S corps) and limited liability companies taxed as partnerships or S corps.

Tax law can impact the after-tax cash flows and investment returns of businesses and business owners. Consequently, tax law changes can affect business valuations and the resulting indications of value. This is particularly true when the changes are both temporary and permanent in nature and affect C corporations (C corps), PTEs and their respective ownership interests in similar and dissimilar ways. The Act contains all of these types of changes and will fundamentally alter the way analysts conduct business valuations in 2018 and beyond.

The remarkable speed by which this legislation passed has left many attorneys, advisors, business owners and analysts uncertain as to how the Act will impact business values. In this article, I'll address some of the more significant aspects of the Act and provide an overview of how they may impact the absolute and relative values of C corps and PTEs.

Business Valuation Factors

The Act contains temporary and permanent changes that will materially impact the valuation of businesses and their respective ownership interests, including:

1. permanent reduction of the corporate income tax rate from 35 percent to 21 percent;
2. permanent limitations on the deductibility of business interest expense;
3. temporary bonus depreciation for purchases of qualified property;
4. temporary limitation of individual deductions for state and local taxes;
5. temporary changes in the individual income tax rate schedules; and
6. temporary PTE earnings deduction of 20 percent of qualified business income.

In addition to the changes listed above, the Act contains modifications to the taxation of foreign earnings of businesses that operate internationally. These changes are material and can impact the cash flows and values of both C corps and PTEs with overseas operations. A comprehensive discussion of these issues is beyond the scope of this article. Consequently, I'll focus my discussion on the valuation-related characteristics of the Act that relate to businesses operating in the United States.

Corporate Income Tax Rate

The permanent reduction of the corporate income tax rate from 35 percent to 21 percent will apply to tax years beginning after Dec. 31, 2017. This tax rate reduction could increase the after-tax cash flows and values of C corps by 20 percent. However, there's a potential negative impact for companies with debt in their capital structure. The tax rate reduction may also increase the after-tax cost of debt capital,

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