Ways and Means Committee Release Text of Tax Reform Bill

November 2, 2017

Today, the House Ways and Means Committee released the Tax Cuts and Jobs Act (H.R. 1) to overhaul major aspects of the US tax system. Originally scheduled for release on Wednesday, November 1, Ways and Means Committee Chairman Kevin Brady (R-Tex.) postponed the bill's unveiling by one day, largely in order to negotiate with Republicans from high-tax states who threatened to oppose the bill if it eliminated the federal deduction for state and local taxes (SALT). In the bill released today, the deduction for state and local taxes is eliminated, with a limited exception for state and local property taxes up to $10,000.

The bill would cut the corporate tax rate to 20 percent. It also would apply a 25 percent rate to business income earned by owners and shareholders of certain pass-through entities. The bill would also adopt a territorial system of international taxation, an immediate tax on existing retained offshore earnings, a new tax on foreign subsidiary high returns, a new excise tax on certain payments from US companies to related foreign companies and new thin capitalization rules.

The bill is widely seen as the beginning of an ongoing negotiation. Chairman Brady indicated that he plans to release a chairman's mark as soon as tomorrow that incorporates feedback from members. The bill is scheduled for committee markup on Monday, November 6. In addition, the Senate Finance Committee is working on its own tax reform plan.

Major provisions of the legislation include:

BUSINESSES - GENERAL

- Corporate Rate
  - The bill reduces the corporate rate from 35 percent to 20 percent effective for tax years beginning after 2017, with no sunset. The bill also repeals the corporate alternative minimum tax.
- Pass-through Rate
  - Under current law, sole proprietorships, partnerships, limited liability companies and S corporations are generally treated for federal income tax purposes as "pass-through" entities subject to tax at the owner or shareholder level rather than at the entity level. Net income earned by an individual owner or shareholder of one of these entities is reported on the individual's income tax return and is subject to ordinary income tax rates, up to the top individual marginal rate of 39.6 percent.
  - The bill provides for a special maximum 25 percent ordinary income tax rate that would apply to the "qualified business income" of individuals engaged in business activities through sole proprietorships, tax partnerships, and S corporations. Business income not qualifying as such would remain subject to the normal ordinary income tax rate schedule.

- The determination of whether income is "qualified business income" depends on whether such income is derived from passive or active business activities. The determination of whether a taxpayer is active or passive with respect to a particular business activity would rely on the current material participation rules in section 469 and the underlying regulations.

- Income of passive owners would be treated entirely as qualified business income.

- A 30/70 rule would generally apply to income derived from active business activity—30 percent of such net income (the "capital percentage" portion of such income) would be treated as qualified business income, while the remaining 70 percent would be subject to ordinary income tax rates.

- Alternatively, active business owners may elect to apply a formula based on the facts and circumstances of their business to determine a capital percentage of greater than 30 percent. The formula would measure the capital percentage based on a rate of return (the Federal short-term rate plus 7 percentage points) multiplied by the capital investments of the business. The election of this alternative formula would be binding for a five-year period.

- Certain items, such as income subject to preferential rates (*e.g.*, net capital gains and qualified dividend income) and certain investment income (*e.g.*, short-term capital gains, dividends, and foreign currency gains and hedges not related to the business needs) would not be eligible to be recharacterized as qualified business income.

- A special rule would apply to prevent the recharacterization of actual wages paid as qualified business income. An owner's or shareholder's capital percentage would be limited if actual wages or income treated as received in exchange for services from the pass-through entity (such as a guaranteed payment) exceeds the taxpayer's otherwise applicable capital percentage.

- The default capital percentage for certain personal services businesses (such as those involved in the performance of services in the fields of law, accounting, consulting, engineering, financial services, or performing arts) would be zero percent. However, such businesses also could elect to use an alternative capital percentage, subject to certain limitations. Such an election is intended to provide some relief to personal service businesses that, nevertheless, have significant capital investments.

- The bill also proposes to eliminate the preferential self-employment tax treatment for shareholders of S corporations and limited partners of partnerships by treating a "labor percentage" of net income derived from carrying on a business by any individual as earnings subject to the self-employment tax (whether such individual carries on such business as a sole proprietorship, a shareholder of an S corporation, or a partner of a tax partnership). The "labor percentage" is generally equal to one minus the "capital percentage" used for the special maximum 25 percent rate on qualified business income.

- The bill also would repeal the partnership technical termination rule. Thus, a partnership would be treated as continuing even if more than 50 percent of the total capital and profits interests of the partnership are sold or exchanged within a year, which would prevent partnerships from being required or being permitted to make new elections for various accounting methods, depreciation lives, and other purposes.

- The bill does not contain any specific changes to the treatment of carried interest.

- Additionally, the bill does not include any technical changes to the new partnership audit and litigation regime scheduled to take full effect in 2018. Such changes may be included as the bill works its way through the legislative process.

- International Provisions

  - *Dividend-Exemption System.* For distributions made after 2017, the bill proposes a dividend-exemption (or "territorial") system in which 100 percent of the dividends paid by a foreign corporation to a 10 percent US corporate shareholder would be exempt from US taxation. No foreign tax credit or deduction would be allowed for any foreign taxes (including withholding taxes) with respect to any exempt dividend. (However, indirect foreign tax credits would be available to offset US tax on subpart F income.) In addition, no deductions for expenses allocable to an exempt dividend would be taken into account for purposes of determining the US corporate shareholder's foreign-source income. Section 956 would be repealed. In addition, a US parent would be required to reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividends received by the US parent from its foreign subsidiary—but only for purposes of determining the amount of a loss on any sale or exchange of the foreign stock by its US parent. The dividend exemption system would be supplemented by several anti-base erosion measures, discussed below.

  - *Transition Tax.* To transition to the new system, a 10 percent US shareholder of a foreign subsidiary would be required to include in income for the subsidiary's last tax year beginning before 2018 the shareholder's pro rata share of the net post-1986 historical earnings and profits (E&P) of the foreign subsidiary to the extent such E&P has not been previously subject to US tax. To the extent the

E&P is retained in cash or cash equivalents, it would be taxed at a 12 percent rate. All other E&P would be taxed at 5 percent. Foreign tax credit carryforwards would be fully usable and foreign tax credits triggered by the deemed repatriation would be partially available to offset the US tax. The different rates reflect an acknowledgment that current tax on earnings reinvested in business assets is arguably less justified and likely harder for companies to fund. At the election of the US shareholder, the tax liability would be payable over a period of up to eight years, in equal annual installments of 12.5 percent of the total tax liability due.

- *Modifications to Subpart F.* The bill largely retains subpart F, with certain modifications, including making the look-through rule permanent, adjusting the *de minimis* exception for foreign base company income, repealing certain rules relating to foreign shipping income and foreign base company oil related income. In addition, the stock attribution rules would be modified so that a US corporation would be treated as constructively owning stock held by its foreign shareholder. The requirement that a US parent of a CFC own stock in the foreign subsidiary for an uninterrupted period of 30 days or more during the year would also be repealed.

- *Source Rules for Inventory Property.* Income from the sale of inventory property produced within and sold outside the United States (or vice versa) would be allocated and apportioned between sources within and outside the United States solely on the basis of the production activities with respect to the inventory.

- *Tax on "Foreign High Returns."* The bill would subject a US parent of one or more foreign subsidiaries to current US tax on 50 percent of the US parent's "foreign high returns." Foreign high returns would be measured as the excess of the US parent's foreign subsidiaries' aggregate net income over a routine return (7 percent plus the federal short-term rate) on the foreign subsidiaries' aggregate adjusted bases in depreciable tangible property, adjusted downward for interest expense. The provision could result in a large tax for US multinationals across a variety of industries, especially those with foreign businesses that are not capital-intensive. Foreign high returns would be treated similarly to currently-taxed subpart F income, including for purposes of allowing a foreign tax credit.

- *Limitation on Interest Deductibility for International Financial Reporting Group.* The bill would limit the deduction of interest by US corporations that are members of an international financial reporting group by limiting deductible net interest expense to the extent the US corporation's share of the group's global net interest expense exceeds 110 percent of the US's share of the group's global earnings before interest, taxes, depreciation, and amortization (EBITDA). An international financial reporting group is any group of entities that (a) includes at least one foreign corporation engaged in a US trade or business or at least one US corporation and one foreign corporation, (b) prepares consolidated financial statements, and (c) reports annual gross receipts for the three-year reporting period in excess of $100 million. The limitation would apply in addition to the

general rules for interest expense disallowance (i.e., the 30 percent of EBITDA limitation described below), with the interest disallowance determined under whichever provision denied the greater amount.

- *20 Percent Excise Tax on Payments to Related Foreign Corporations.* Payments (other than interest) made by a US corporation to a related foreign corporation that are deductible, includible in costs of goods sold, or includible in the basis of a depreciable or amortizable asset would generally be subject to a 20 percent excise tax, unless the related foreign corporation elected to treat the payments as income effectively connected with the conduct of a US trade or business. This provision would apply only to international financial reporting groups with payments from US corporations to their foreign affiliates totaling at least $100 million annually. The provision would be effective for tax years beginning after 2018. The provision is similar to a surtax advocated by University of Houston Law Center Professor Bret Wells in his testimony before the Senate Finance Committee on October 3, 2017.

- *PFIC Insurance Exception Modification*. Under current law, passive income for purposes of the PFIC provisions does not include income derived in the active conduct of an insurance business if the PFIC is predominantly engaged in an insurance business and would be taxed as an insurance company if it were a US corporation. This rule would be modified to apply only if the foreign corporation would be taxed as an insurance company if it were a US corporation and if loss and loss adjustment expenses, unearned premiums, and certain reserves constitute more than 25 percent of the foreign corporation's total assets (or 10 percent in certain cases). The modification would thus target certain insurance company structures linked to hedge funds. Such arrangements were targeted by Treasury and the IRS in regulations proposed in 2015 that have not been finalized.

- *Limitation on Treaty Benefits.* Under the bill, if a payment of fixed or determinable, annual or periodical (FDAP) income is deductible in the United States and the payment is made by an entity that is controlled by a foreign parent to another entity in a tax treaty jurisdiction that is controlled by the same foreign parent, then the statutory 30-percent withholding tax on such income would not be reduced by any treaty unless the withholding tax would be reduced by a treaty if the payment were made directly to the foreign parent. This provision would be effective for payments made after the date of enactment. Similar provisions have appeared in several older tax bills and have been criticized as overriding US tax treaties.

- *Rules Relating to US Territories.* The bill would also modify certain provisions related to territories of the United States, including extending the deduction allowable with respect to income attributable to domestic production activities in Puerto Rico, extending the temporary increase in limit on "cover over" of rum excise taxes to Puerto Rico and the Virgin Islands, and extending the American

Samoa economic development credit.

- Business Deductions
  - *Interest*. Under the bill, the amount of interest that can be deducted by any business with gross receipts of $25 million or more is generally limited to 30 percent of the business's adjusted taxable income. The provision would not apply, however, to certain regulated public utilities and real property trades or businesses (i.e., "any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business"). Adjusted taxable income is defined as the business's taxable income computed without regard to interest, net operating losses, depreciation, amortization, and depletion. Any interest amounts disallowed would be allowed to be carried forward for five years. Disallowance would be determined at the tax filer level. The bill would repeal the existing limitations under section 163(j) but would apply in addition to the limitation on interest deductibility for international financing reporting groups, discussed above.
  - *Net Operating Losses*. The bill modifies the treatment of net operating losses by limiting the use of a net operating loss carryover or carryback to 90 percent of the taxpayer's taxable income (similar to the effect of the alternative minimum tax rule under current law). The bill also eliminates all net operating loss carrybacks except for a special one-year carryback for small businesses and farms in the case of certain casualty and disaster losses.
  - *Depreciation and Expensing*. The bill would provide for additional accelerated depreciation—immediate expensing of all the cost (instead of the present law 50 percent of cost) for property described in section 168(k)—generally property with a life of 20 years or less, computer software and certain other property. Property qualifying for immediate expensing would not include regulated public utility property or property used in a real property trade or business.
  - *Like-Kind Exchanges.* The bill would limit like-kind exchanges under section 1031 to exchanges of real property. The bill includes a transition rule to allow like-kind exchanges for personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

ENERGY

- *Production tax credits.*
  - Currently, a taxpayer may claim a production tax credit for producing electricity at a facility using qualified resources during the 10-year period beginning on the date the facility was originally placed in service. For this purpose, qualified

resources consist of wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. The base amount of the credit is 1.5 cents per kilowatt hour. Indexed for inflation, the rate for projects where construction began before 2017 is 2.4 cents for 2017 (the rate was 2.3 cents for 2016) and 1.9 cents for projects where construction begins in 2017.

  - The credit is generally available for wind facilities the construction of which begins before 2020 and for facilities using other qualified resources where construction began before 2017.

  - Under the bill, the inflation adjustment would be repealed. In addition, unless there is a continuous program of construction for a facility, the construction of that facility "shall not be treated as beginning before any date."

- *Modification of the energy investment tax credit.*

  - A taxpayer may claim an investment credit computed by reference to the basis of eligible energy property once the property is placed in service. Eligible energy property consists of solar energy, fiber-optic solar energy, geothermal energy, qualified fuel cell, qualified microturbine, combined heat and power system, qualified small wind energy, and thermal energy properties. The percentage of the credit available depends upon the type of property and the date when construction begins.

  - The bill would generally harmonize the expiration dates and phase-out schedules. Under the bill, the 30 percent credit for solar energy, fiber-optic solar energy, qualified fuel cell, and qualified small wind energy property would be available for property the construction of which begins before 2020 and would be phased out for property the construction of which begins before 2022, with no credit available for property the construction of which begins after 2021. The 10 percent credit for qualified microturbine, combined heat and power systems, and thermal energy property would be available for property the construction of which begins before 2022. The "permanent" 10 percent credit for solar energy and geothermal energy property is eliminated for property the construction of which begins after 2027.

  - The bill would clarify that the construction of any facility, modification, improvement, addition, or other property may not be treated as beginning before

any date unless there is a continuous program of construction which begins before such date and ends on the date that such property is placed in service.

- *Extension and phaseout of residential energy efficient property.*

  - A taxpayer could claim a 30 percent credit for the purchase of qualified geothermal heat pump property, qualified small wind energy property, and qualified fuel cell power plants placed in service before 2017 and could also claim a credit for qualified solar electric property and qualified solar water heating property (not used for heating swimming pools and hot tubs) placed in service prior to 2022 (subject to a reduced rate of 26 percent for property placed in service during 2020 and 22 percent for property placed in service during 2021).

  - Under the bill, the credit for residential energy efficient property would be extended for all qualified property placed in service prior to 2022, subject to a reduced rate of 26 percent for property placed in service during 2020 and 22 percent for property placed in service during 2021.

- *Repeal of enhanced oil recovery credit.*

  - Taxpayers may claim a credit equal to 15 percent of enhanced oil recovery costs. The credit is ratably reduced over a $6 phase-out range when the reference price for domestic crude oil exceeds $28 per barrel (adjusted for inflation after 1991). Based on current prices, the credit is fully phased-out.

  - The bill would repeal the credit for tax years after 2017.

- *Repeal of credit for producing oil and gas from marginal wells.*

  - Producers may claim a $3-per-barrel credit (adjusted for inflation) for the domestic production of crude oil and a 50-cents-per-1,000-cubic-feet credit (also adjusted for inflation) for the domestic production of qualified natural gas. The credit is not available for production if the reference price of oil exceeds $18 ($2 for natural gas). The credit is reduced proportionately for reference prices between $15 and $18 ($1.67 and $2 for natural gas). The credit is now phased out completely based on the current price of a barrel of oil.

  - The bill would repeal the credit for years after 2017.

- *Modifications of credit for production from advanced nuclear power facilities.*

  - A taxpayer may claim a credit for electricity produced at a qualifying advanced nuclear power facility for an 8-year period beginning when the facility is placed in service. The credit provides for a maximum 6,000 megawatts of national capacity allocated by the Secretary of the Treasury. To qualify, a taxpayer must have submitted an application with respect to a nuclear facility before February 1, 2014, and must have received an allocation from the available national megawatt capacity with respect to the facility. All 6,000 megawatts of national capacity have been allocated.

  - The nuclear production tax credit may be allocated among partners in a partnership, effectively allowing for the transfer of such credits in certain circumstances.

  - Under the bill, the credit allocation process would be clarified and a credit transfer provision would be added. Beginning after January 1, 2021, the Secretary of the Treasury would reallocate any national megawatt capacity remaining under the cap, first to qualifying facilities to the extent such facilities did not receive an allocation equal to their full capacity and then to facilities placed in service after such date in the order in which such facilities are placed in service. Certain public entities would be eligible for an election to transfer advanced nuclear production tax credits to specified project participants involved in design or construction, persons providing nuclear steam supply systems or nuclear fuel, persons with an ownership interest, and partners in a partnership with an ownership interest.

INSURANCE COMPANIES

- Life insurance companies

  - The bill modifies section 805 and repeals sections 810 and 844 to make the operations loss carry over and back provisions of Section 172 applicable to life insurance companies. Thus, companies would carry operations losses back up to two (instead of three) years and forward up to 20 (instead of 15) years.

  - The bill repeals the section 806 small life insurance company deduction.

  - The bill amends the section 807 reserve computation rules. Companies would compute “reserves for future unaccrued claims” and take into account 76.5 percent of the increase or decrease in such reserves in computing taxable

income. Reserves for future unaccrued claims are the life insurance reserves, discounted unpaid losses and other reserves reported on the annual statement, but excluding deficiency reserves, asset adequacy reserves and other types of reserves identified in IRS guidance. If the year-end reserve at the end of the pre-effective date year differs from the opening reserve of the effective date year the difference is taken into account ratably over an eight-year spread period.

- The bill amends section 807(f) to eliminate the special rule for changes in computing reserves and to require instead use of the generally applicable section 481 change in accounting method rules.
- The bill amends section 812 to specify that for proration purposes the company's share is 40 percent and the policyholders' share is 60 percent.
- The bill repeals section 815, which applies to distributions from a stock life insurer's pre-1984 policy holders surplus account. If a company has a remaining balance in such account at the end of the pre-effective date year that balance is brought into income ratably over eight years.
- The bill amends the section 848 policy acquisition expense rules by replacing the three categories of specified insurance contracts with two categories: group contracts and all other specified contracts. For group contracts, the specified policy acquisition expenses are net premiums times 4 percent and for other contracts the specified policy acquisition expenses are net premiums times 11 percent.

- Non-life insurance companies
  - The bill amends section 832 to provide that, for proration purposes, the reduction in the losses incurred deduction attributable to tax-exempt interest and the dividends received deduction is increased from 15 percent to 26.25 percent of such amounts.
  - The bill amends section 846 to amend the discounting rules used to determine discounted unpaid losses. First, the applicable interest rate for determining discounted unpaid losses is the corporate bond yield curve specified by Treasury. Second, the computational rules for loss payment patterns are modified by applying the loss payment pattern for long-tailed business lines to all lines of business, but with the five-year limitation on extensions to the payment period increased to 15 years. In addition, the election to use a company's historic payment pattern is repealed. Any transition adjustment is taken into account ratably over eight years.
  - The bill repeals section 847 and the special estimated tax payment rules related to the difference between discounted and undiscounted reserves.

INDIVIDUALS

- Individual Rates and Standard Deduction
  - Individual income tax brackets are set at 12, 25, 35, and 39.6 percent. The highest individual tax rate of 39.6 percent would apply to taxpayers with over $1 million in annual income;
  - The standard deduction is increased to $12,000 for individuals and $24,000 for married couples;
- State and Local Tax Deduction
  - The bill generally eliminates the deduction for state and local taxes, except for a limited deduction for state and local property taxes up to $10,000;
- Mortgage Interest Deduction
  - The bill would further limit the individual deduction of home mortgage interest. For mortgage debt incurred after November 2, 2017, the current loan limit of $1 million for deductible interest is reduced to $500,000.
  - The bill would also only allow interest to be deductible on a mortgage of a principal residence, rather than a principal residence and one other residence as permitted under existing law.
  - The bill would not allow interest on home equity debt incurred after November 2, 2017.
  - Under the bill, debt incurred prior to November 2, 2017 that is refinanced after November 2, 2017 is treated as incurred on the date the original debt was incurred.
  - The bill would treat debt pursuant to loans subject to a binding written contract before November 2, 2017 as incurred prior to November 2, 2017.
- Retirement Savings
  - The proposal makes no change to current 401(k) limits, which allow 401(k) plan participants to voluntarily contribute up to $18,000 per year (plus an additional $6,000 if they are age 50 or over) on a pre-tax basis.
  - Early drafts of the proposal would have limited the pre-tax contribution amount to as little as $2,400 per year, and required that additional contributions be made on an after-tax basis through a so-called "Roth" 401(k) feature, changes that were expected to raise significant revenue over 10 years. Contributing on a pre-tax basis allows 401(k) participants to avoid current Federal income taxes (and, in most cases, state income taxes), with contributions and earnings instead being taxed at retirement. Some employers also give their 401(k) plan participants the option to contribute all or a portion of their $18,000 limit ($24,000 for those 50 or over) on an after-tax basis through a Roth 401(k) feature. A Roth 401(k) feature provides for federal taxation when contributions are made, but distributions of

contributions and earnings then avoid any federal taxation at retirement.

- The 401(k) limits were dropped from the proposal after receiving criticism by the financial services industry, plan sponsors and the White House over concerns that participants would react by decreasing their contributions. Even when a Roth 401(k) feature is offered, most 401(k) participants still choose to make traditional pre-tax contributions. This may be because 401(k) participants prefer an immediate tax benefit instead of a deferred tax benefit, or they project having the benefit of a lower marginal income tax rate at retirement, or they simply are more familiar with pre-tax contributions and want to avoid added complexity. In addition, even if employers were to make a Roth 401(k) feature fully available to participants, and participants were to contribute enough to maximize employer matching contributions, there was a concern that participants would react to a mandated after-tax treatment by decreasing their unmatched 401(k) contributions in order to keep their take home pay at the same level. The proposal also would have added complexity for 401(k) plan sponsors and participants, and would have increased the need for participant education on how Roth 401(k) contributions work, particularly regarding the deferred tax benefits provided by a Roth 401(k) feature.

- Child Tax Credit
  - The child tax credit is increased to $1,600 from $1,000 per child under 17, with an additional $300 credit for non-dependent children.
  - The bill introduces a new family flexibility credit of $300 for each parent effective for taxable years ending before January 1, 2023.
- Estate Tax
  - The bill doubles the exemption from the estate tax from $5 million to $10 million (adjusted for inflation from 2011) and repeals the estate tax completely on January 1, 2024.
  - The bill also includes the basic exclusion amount for gift and generation-skipping transfers to $10,000,000 (adjusted for inflation).
  - The bill would eliminate the estate tax for decedents dying after December 31, 2023. The generation-skipping transfer tax is also eliminated for transfers after December 31, 2023.
  - Estate, gift and generation-skipping transfers made on or before December 31, 2023 would still be subject to a maximum tax rate of 40 percent (no change in rates).
  - The bill does not eliminate the gift tax. Gifts made after December 31, 2023 would be subject to a maximum gift tax rate of 35 percent (reduced from the current maximum rate of 40 percent).

- Under the bill, the basis step up under section 1014 for property received from a decedent at death would be retained even after the estate and generation skipping transfer taxes are repealed.

EXEMPT ORGANIZATIONS

The bill proposes several modifications to the rules governing exempt organizations, including subjecting certain private colleges and universities to a 1.4% excise tax on net investment income, permitting churches to make statements relating to political campaigns in the ordinary course of religious services and activities, clarifying and expanding certain provisions of the unrelated business income tax (UBIT) rules, and imposing an excise tax on compensation of certain tax-exempt organization employees. In addition, the bill would be replace the current two-tier private foundation excise tax on net investment income with a single rate of 1.4%, require an art museum claiming the status of a private operating foundation to be open to the public for at least 1,000 hours per year, and create an exception from the private foundation excess business holdings tax for independently-operated philanthropic business holdings. Other provisions of the bill, such as the expansion of the standard deduction, the repeal of certain itemized deductions, the reduction in marginal income tax rates, and the amendment and repeal of the estate tax, would weaken incentives for charitable giving.

November 13, 2017

A Comparison of Current Law and House and Senate Versions of the “Tax Cuts and Jobs Act”

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	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
INSURANCE COMPANIES			
Life Insurance Company Carryforward and Carryback Rules	- Life insurance companies may carryover operations losses up to 15 years and carryback operations losses up to three years.	- The bill would modify IRC § 805 and repeal IRC §§ 810 and 844 to make the operations loss carryover and carryback provisions of IRC § 172 applicable to life insurance companies. Thus, life insurance companies would carry operations losses back up to two (instead of three) years and forward up to 20 (instead of 15) years.	- The operations loss deduction for life insurance companies would be repealed effective for losses arising in taxable years after December 31, 2017, but NOL would be deductible under IRC § 172. - To calculate the deduction under Section 172, the NOL for any taxable year would be treated as the excess of the life insurance deductions for such taxable year over the life insurance gross income for such taxable year
Small Life Insurance Company Deduction	- Under IRC § 806, life insurance companies may deduct 60% of their first $3 million of life insurance-related income. This deduction is phased out for life insurance companies with between $3 million and $15 million in income, and is not available for companies with assets of $500 million or more.	- The IRC § 806 small life insurance company deduction would be repealed.	- The IRC § 806 small life insurance company deduction would be repealed.
Surtax on Life Insurance Company Taxable Income	- None.	- The House legislation includes a "placeholder" provision intended to preserve current tax treatment of deferred acquisition costs, life insurance company reserves, and proration. The placeholder provision also includes an 8% surtax on life insurance company income.	- None.
Change in Computing Life Insurance Company Reserves	- IRC § 807(f) provides that for life insurance companies, a change in computing reserves may be taken into account over ten years (regardless of whether the adjustment reduces or increases taxable income).	- The special rule under IRC § 807(f) for changes in computing life insurance reserves would be eliminated, and generally applicable IRC § 481 change in accounting method rules would apply. Adjustment would be made with the consent of the IRS.	- Income or loss resulting from a change in computation method for life insurance company reserves would be taken into account consistent with IRS procedures (generally ratably over a four-year period).
Dividends Received Deduction for Life	- Under IRC § 812, deductions related to the receipt of exempt income may be disallowed	- Rules for proration under IRC § 812 would be modified: effective for taxable years	- Not addressed in Senate bill.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
Insurance Companies	or limited for life insurance companies. Life insurance companies must reduce deductions (including dividends-received deductions and reserve deductions) according to a formula that computes the respective shares of net investment income that belong to the company and to the policyholders.	beginning after December 31, 2017, the company portion would be 40% and the policyholder portion would be 60%.	
Distributions to Shareholders from Pre-1984 Policyholders Surplus Account	- Tax rules enacted in 1959 provided that half of a life insurer's operating income was taxed only when distributed by the company, and untaxed income was accounted for in a "policyholders surplus account." This deferral of taxable income was repealed in 1984, but existing policyholders' surplus account balances remained untaxed until they were distributed. A 2004 law created a two-year tax holiday that allowed tax-free distributions of these policyholders' surplus account balances during 2005 and 2006.	- The bill would repeal IRC § 815, which applies to distributions from a stock life insurer's pre-1984 policyholders surplus account. If a company has a remaining balance in such account at the end of the pre-effective date year that balance would be brought into income ratably over eight years.	- The Senate bill is virtually identical to the House bill with respect to this provision. The Senate proposal would repeal IRC § 815. As of December 31, 2017, tax would be imposed on the balance of an existing policyholders surplus account. A life insurance company would be required to pay tax on the balance of the account ratably over eight years.
Capitalization of Policy Acquisition Expenses	- In general, specified insurance company policy acquisition expenses for any taxable year must be capitalized and amortized over ten years. Specified policy acquisition expenses are the lesser of (1) a specified percentage[1] of net premiums received on each of a company's three categories of insurance contracts; or (2) the company's general deductions.	- Would preserve current tax treatment of deferred acquisition costs.	- Would lengthen the amortization period for specified policy acquisition expenses from 10 years to 50 years. - Would increase the specified percentage of net premiums companies use to calculate policy acquisition costs: from 1.75% to 3.17 for annuity contracts; from 2.05% to 3.72% for group life insurance contracts; and 7.70% to 13.97% for all other specified insurance contracts.
Property and Casualty (P&C) Loss Reserve Deduction Rules	- Under IRC § 832, deductions are limited or disallowed in certain circumstances if they are related to the receipt of exempt income. Under proration rules, property and casualty	- The bill would amend IRC § 832 to increase the amount by which a P&C insurer must reduce its loss reserve deduction. Reserve deductions for losses incurred must	- Like the House bill, the Senate bill would increase the amount by which a P&C insurer must reduce its loss reserve deduction: instead of a 15% reduction, P&C

[1] The specified percentage is 1.75% for annuity contracts, 2.05% for group life insurance contracts, and 7.7% for all other specified insurance contracts.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
	(P&C) insurance companies must reduce reserve deductions for losses incurred by 15% of (1) the company's tax-exempt interest, (2) the deductible portion of dividends received, and (3) the increase in the cash value of the life insurance, annuity, or endowment contracts owned by the company during the tax year.	be reduced by 26.25% (up from 15% under current law) of (1) the deductible portion of dividends received; (2) tax exempt interest; and (3) the increase for the tax year in the cash value of annuity, endowment, or life insurance contracts owned by the company.	insurers would be required to calculate a reduction equal to 5.25% divided by the top corporate tax rate. -Under the Senate bill, the top corporate tax rate would drop from 35% to 20% beginning in 2019. Thus, the reduction percentage for an insurance company's loss reserve deduction would be 15% for 2018, and 26.25% beginning in 2019.
P&C Insurance Companies Discounting Rules	- Under IRC § 846, a P&C insurance company may deduct unpaid losses that are discounted using mid-term applicable federal rates and based on a loss payment pattern. The loss payment pattern for each line of business is determined by reference to the industry-wide historical loss payment patterns (though companies may elect to use their own company-specific historical loss payment patterns). The payment pattern computation incorporates the assumption that all losses are paid during the accident year and the three following calendar years (or during the accident year and the ten following calendar years for lines of business related to medical malpractice, workers' compensation, international coverage, multiple peril lines, reinsurance, and auto-related or other liability). Long-tail lines of business are subject to a rule that extends the loss payment pattern period and treats the amount of losses which would have been treated as paid in the tenth year following the accident year as paid in the tenth year and in each subsequent year (up to five years) in an amount equal to the amount treated as paid in the ninth year following the accident year.	- The House bill would amend the IRC § 846 discounting rules used to determine discounted unpaid losses. First, the applicable interest rate for determining discounted unpaid losses would be the corporate bond yield curve specified by Treasury, rather than mid-term applicable federal rates. Second, the computational rules for loss payment patterns would be modified by applying the loss payment pattern for long-tailed business lines to all lines of business, but with the five-year limitation on extensions to the payment period increased to 15 years. Additionally, the election to use a company's historic payment pattern would be repealed. Any transition adjustment would be taken into account ratably over eight years.	- Not addressed in Senate bill.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
Special Estimated Tax Payments	- IRC § 847 allows an insurance company to elect to claim a deduction equal to the difference between the amount of reserves computed on a discounted basis and the amount computed on an undiscounted basis, so long as the company pays a special estimated tax equal to the tax benefit attributable to the deduction.	- The bill would repeal IRC § 847 and the special estimated tax payment rules related to the difference between discounted and undiscounted reserves.	- Would modify the proration and discounting rules under IRC § 847 to require a reduction in losses equal to 5.25% divided by the top corporate tax rate. Effective beginning in 2018.
COMPENSATION AND RETIREMENT SAVINGS			
Nonqualified deferred compensation	- Compensation generally is taxable to an employee and deductible by an employer in the year earned. - However, for non-qualified deferred compensation, the employee does not take such compensation into income until the year received, and the employer's deduction is postponed until that time. The employee generally must take non- qualified deferred compensation into income, however, if the compensation is put into a trust protected from the employer's creditors in bankruptcy as soon as there is no substantial risk of forfeiture with regard to the compensation.	- Note that the House originally proposed to repeal § 409A like the Senate, but this was removed in the manager's amendment. - The House bill would permit an election under a new IRC § 83(i) for broad-based deferred compensation plans for non-public companies. - Would clarify that (1) restricted stock units (RSUs) are ineligible for IRC § 83(b) elections; and (2) apart from Section 83(j), Section 83 does not apply to RSUs.	- The bill would repeal the deferred compensation rules in § 409A and replace them with new § 409B, which would make deferred compensation taxable when there is no substantial risk of forfeiture(i.e., vesting provisions lapse), effective for services performed after 2017.
Deduction for executive compensation	- For publicly traded corporations, the deduction for compensation paid or accrued with respect to covered employees is limited to no more than $1 million per year, subject to certain exceptions, including commissioner, performance-based remuneration, such as stock options, and payments to a tax-qualified retirement plan. - Covered employees include the CEO and 4 most highly compensated officers other than the CEO.	- The $1 million deduction cap on executive compensation would be changed to include commissions and performance-based compensation. - The provision would also change the definition of covered employee to include the CEO, the CFO, and the three other highest paid employees.	- The Senate bill would make the same amendments as the House bill. - In addition, the applicability of the limitation would be expanded to include foreign companies publicly traded through ADRs.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
Deduction of entertainment expenses	- No deduction is allowed with respect to entertainment, amusement, or recreation activities or facilities (including membership dues), unless the taxpayer establishes that they were directly related to the taxpayer's trade or business, in which case, the taxpayer may deduct up to 50%.	- Disallows deduction for entertainment expenses. - Applies 50% limitation to expenses for food or beverages and qualifying business meals.	- Same as House.
Fringe benefits	- A taxpayer may deduct the cost of certain fringe benefits provided to employees (e.g., employee discounts, working conditions, and transportation fringe benefits), even though the benefits are excluded from the employee's income.	- Disallows deduction for transportation fringe benefits, on-premises gyms and other athletic facilities, or for amenities provided to an employee that are primarily personal in nature, unless such benefits are treated as taxable compensation to the employee.	- Disallows deductions for transportation fringe benefits, except as necessary for the safety of the employee.
Retirement Plans	- A special rule allows an individual to elect to recharacterize a contribution to a traditional IRA as a contribution to a Roth IRA and vice versa. - As an exception to the rule that defined contribution plans are not permitted to made in-service distributions, employees may receive hardship distributions. Hardship distributions are limited to the amounts actually contributed by the employer. Under IRS guidance, 401(k) plans that allow employees to take hardship distributions must require the employee to suspend making contributions for six months. - Employees may take a loan from a defined contribution plan. But if an employee terminates his or her employment, rolls over the remaining account balance, and does not contribute the loan balance to the IRA, the loan is treated as a distribution subject to a 10% additional tax.	- The bill would repeal the rule that allows an individual to re-characterize a contribution to a traditional IRA as a contribution to a Roth IRA (and vice versa). - The bill would modify the rules governing hardship distributions by requiring the IRS to change its guidance to allow employees who receive hardship distributions to continue to make plan contributions, without waiting the six months. It would also allow plans to permit hardship distributions of employer contributions as well as earnings. - The bill would extend the period of time during which a plan participant may rollover a plan loan in the event the employee separates from service, or the plan terminates, while a loan is outstanding, from 60 days to the due date of the employee's tax return. - Certain nondiscrimination rules would be modified in order to protect older, longer service participants by expanding an employer's ability to cross-test between	- The Senate proposal does not contain any of the House amendments. - The Senate proposal would eliminate catch-up contributions for high wage earners. Under the proposal, an employee could not make catch-up contributions for a year in which the employee received wages of $500,000 or more for the preceding year.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
		defined benefit and defined contribution plans.	
401(k) Plans	- 401(k) plan participants may voluntarily contribute up to $18,000 per year (plus an additional $6,000 if they are age 50 or over) on a pre-tax basis.	-Current 401(k) limits would remain unchanged.	-Current 401(k) limits would remain unchanged.
Worker classification	- Distinction between employee and independent contractor is based on common law facts and circumstances analysis. - IRC § 530 of the Revenue Act of 1978 provides a safe harbor for employment tax purposes under which the taxpayer may treat a worker as not being an employer unless the taxpayer has no reasonable basis for such treatment.	- No change to current law.	- The Senate proposal would establish a safe harbor for all purposes of the Code under which the taxpayer may treat a worker as not being an employee; the worker generally must (1) incur expenses deductible as trade or business expenses and be reimbursed for most such expenses; (2) agree to work for a particular amount of time, to achieve a specific result, or to complete a specific task; and (3) have a significant investment in the assets or training related to the services, not be required to perform services exclusively for the entity receiving the services, not have performed substantially the same services as an employee of the service recipient during the prior year, or not be compensated based primarily on hours actually worked.
BUSINESSES - GENERAL			
Corporate Rate	- Graduated schedule with a 35% top rate.	- 20% flat rate after 2017; 25% flat rate for personal service corporations. - Corresponding reduction to dividends-received deduction (DRD): the 80% DRD would be reduced to 65% and the 70% DRD would be reduced to 50%.	- 20% flat rate for tax years beginning after 2018; eliminates special rate for personal service corporations. - Corresponding reduction to dividends-received deduction (80%→65%; 70%→50%).
Corporate AMT	- Corporations are generally subject to an alternative minimum tax (AMT) imposed at a flat rate of 20% on a broad tax base. - Certain small corporations are exempt.	- The AMT would be repealed.	- The AMT would be repealed.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
Interest Deduction	- Business interest may be deducted in the tax year in which the interest is paid or accrued, subject to the thin cap limits under IRC § 163(j) - Under Section 163(j), interest deduction is disallowed if a US corporation's debt-to-equity ratio exceeds 1.5 to 1, deduction for interest paid to certain related parties that are not subject to US tax is limited, and taxpayer's net interest expense exceeds 50% of its adjusted taxable income (i.e., taxable income without regard to deductions for interest, NOLs, domestic production activities, depreciation, amortization, and depletion). - Disallowed interest deductions carried forward indefinitely and "excess limitation" carried forward three years.	- Generally, imposes a new restriction on interest deductibility (all businesses, regardless of form, subject to a disallowance of deduction for net interest expense in excess of 30% of the business's adjusted taxable income), but carves out "real property trades or businesses"--any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business--and businesses with average gross receipts of $25M or less from the new restriction. An additional restriction would apply to an "international financial reporting group," i.e., one with at least one foreign corporation with annual gross receipts in excess of $100 million.	- Generally, imposes a new restriction on interest deductibility (all businesses, regardless of form, subject to a disallowance of deduction for net interest expense in excess of 30% of the business's adjusted taxable income); exempts businesses with average annual gross receipts under $15M during the three preceding years, certain regulated public utilities, and electing real property trades or businesses.
Net Operating Losses	- Businesses may carry a net operating loss (NOL) back for two years and forward for 20 years. - AMT rules do not permit an NOL deduction to reduce a taxpayer's alternative minimum taxable income by more than 90%.	-The bill would repeal carrybacks (except for special one-year carryback for small businesses and farms in the case of certain casualty and disaster losses) - The bill would allow indefinite carryforward of NOLs, increased by an interest factor. - Use of NOL carry forward would be limited to 90% of the taxpayer's taxable income.	-The bill would repeal carrybacks (except for certain farming losses) - The bill would allow indefinite carryforward of NOLs (no mention of interest factor). - Use of NOL carry forward would be limited to 90% of the taxpayer's taxable income.
Depreciation and Expensing	- Current law provides for "bonus depreciation" equal to 50% of the cost of qualified property placed in service, phasing down through 2019 (plus one year for certain longer production property). - Qualified property generally includes property with a life of 20 years or less, off-the-shelf computer software, water utility	- The bill would provide for 100% immediate expensing of qualified property placed in service after 9/27/2017 through 2022 (plus one year for certain longer production property). - N/A to certain regulated public utilities, real property trades or businesses, and "floor	- Bonus depreciation would be extended for property placed in service after 9/27/2017 through 2022 (plus one year for certain longer production property) and increased to 100%. - N/A to certain regulated public utilities. - Increases § 179 expensing limit to $1 million and phase-out amount to $2.5

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
	property, and qualified improvement property (i.e., interior improvement in nonresidential buildings); in addition, original use of property must begin with the taxpayer. - Small businesses may immediately expense up to $500,000 of § 179 property (i.e., tangible personal property with a recovery period of 20 years or less, off-the-shelf computer software, qualified leasehold improvements, and qualified restaurant or retail improvement property); phases out for property placed in service of more than $2 million.	plan financing indebtedness" applicable to certain car dealerships. - Repeals requirement that original use must begin with the taxpayer. - Increases § 179 expensing limit to $5 million and phase-out amount to $20 million and indexes both for inflation; expands § 179 property to include qualified energy efficient heating and air-conditioning property.	million and indexes both for inflation; expands § 179 property to include certain tangible depreciable property used predominantly to furnish lodging, and certain improvements to nonresidential buildings.
Like-Kind Exchanges	- No gain or loss is recognized to the extent that property held for investment or for use in a trade or business is exchanged for like-kind property to be held for investment or use in a trade or business. - Applies to a wide range of real and personal property; N/A to inventory, stocks, bonds, partnership interests, certificates of trust or beneficial interest, evidences of indebtedness, livestock, or foreign property.	- Like-kind exchanges would be limited to exchanges of real property. - A transition rule would allow like-kind exchanges for personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property before Dec. 17, 2017.	- Like-kind exchanges would be limited to exchanges of real property not held primarily for sale. - A transition rule would allow like-kind exchanges for personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property before Dec. 17, 2017.
Research and Experimentation	- Under current IRC § 41, taxpayers are allowed a credit equal to 20% of the increase in qualified research expenses for a taxable year over a base amount; taxpayers may elect an alternative simplified computation at a credit rate of 14%. - Under current IRC § 174, taxpayers are allowed a deduction for research and experimental (R&E) expenditures, with certain narrow exceptions.	- No change to R&E credit. - Require capitalization and amortization of R&E expenses ratably over 5 years (15 years for foreign research expenditures).	- No change to R&E credit. - No change to R&E deduction.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
Domestic Production Deduction	- Under current IRC § 199, taxpayers are allowed a deduction equal to 9% of their qualified production activities income (generally income from the disposition of property manufactured, produced, grown, or extracted in the US).	- Repeals the domestic production deduction effective in 2018.	- Repeals the domestic production deduction effective in 2019.
Business Credits	- Current IRC § 47 allows two types of rehabilitation credits: 20% credit for certified historic structures and 10% credit for qualified rehabilitated buildings placed in service before 1936. - Unused general business credits may be carried back one year and forward 20 years; if the credits are unused after the carryover period, the unused credit may generally be deducted. - An employer may claim a work opportunity tax credit equal to 40% of qualified first-year wages of employees belonging to targeted groups. - Qualifying taxpayers may claim a new markets tax credit equal to 5% per year for the first 3 years and 6% per year for the next 4 years for investments in qualified community development entities.	- Repeals the rehabilitation credit; under a transition rule, the credit would continue to apply to expenditures incurred for a 2-year period, which would have to begin within 180 days after 1/1/2018. - Repeals the deduction for unused general business credits. - Repeals the work opportunity tax credit. - Repeals the new markets tax credit.	- Repeals 10% credit for pre-1936 buildings and reduces 20% credit to 10%. - Repeals the deduction for unused general business credits. - Does not change the work opportunity tax credit. - Does not change the new markets tax credit.
PASS-THROUGH ENTITIES			
Pass-through Rate	- Net income earned by an individual owner or shareholder of a sole proprietorship, partnership, LLC, or S corporation is reported on the owner or shareholder's individual income tax return and subject to ordinary income tax rates (up to the top individual marginal rate of 39.6%).	- The bill would create a special maximum 25% ordinary income tax rate that applies to "qualified business income" of individuals doing business through sole proprietorships, tax partnerships, and S corporations. - Business income that is not "qualified" would remain subject to ordinary income tax rates.	- The Senate bill would generally allow an individual taxpayer to deduct 17.4% of domestic "qualified business income" from a partnership, S corporation, or sole proprietorship. - Deduction limited to 50% of the W-2 wages of the taxpayer. - "Qualified business income" generally means net income from a trade or business.

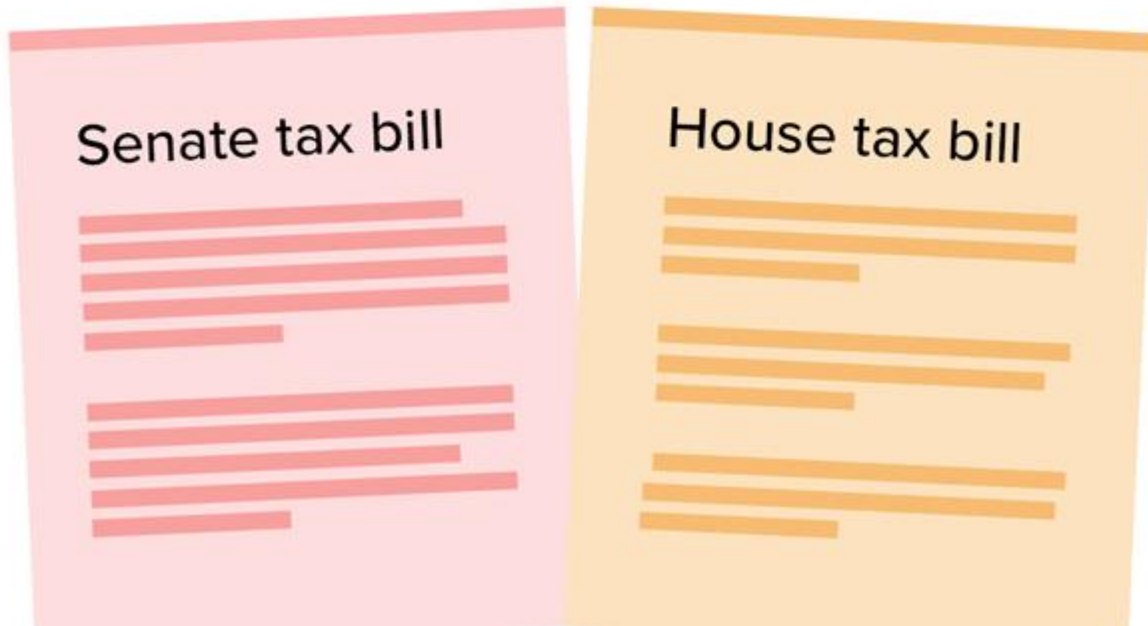
	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
		- Special rate N/A to investment income (e.g., net capital gains and qualified dividend income). - All income from passive business activities (as defined in current IRC § 469) would be treated as qualified business income. - Income from active business activities would be subject to one of two rules, based on taxpayer election: (1) a 30/70 rule under which 30% of such business income would be treated as qualified (the "capital percentage"), while the remaining 70% would be subject to ordinary income tax rates; or (2) a formula based on the facts and circumstances of the business to determine a capital percentage greater than 30%. - The default capital percentage for certain personal services businesses (e.g., law, accounting, consulting, engineering, financial services, or performing arts) would be zero, but such businesses also could elect to use the alternative formula if they have significant capital investments. - The manager's amendment included a new lower individual income tax rate (9%, to be phased in over 5 years) for active owners of passthrough businesses for up to $75,000 of their net business income (for owners with taxable incomes less than $150,000 and then fully phased out at taxable income of $225,000).	It does not include: specified service businesses (except in the case of individuals earning less than $150,000); any amount paid by an S corporation that is treated as "reasonable compensation"; amounts allocated to a partner acting other than in his or her capacity as a partner for services (IRC § 707(a) service payments); guaranteed payments to a partner for services rendered (IRC § 707(c) service payments); or investment income.
Employment Taxes for Pass-through Owners	- Owners that provide services to a partnership are not considered employees for federal tax purposes, but income of partners providing services can be subject to self-	- The bill initially proposed to eliminate the preferential self-employment tax treatment for shareholders of S corporations and limited partners of partnerships by treating a "labor percentage" of pass-through income	- No change to current law.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
	employment taxes. This rule doesn't apply to limited partners. - S corporation shareholders that perform services for the S corporation are considered employees and are subject to employment taxes on their reasonable compensation.	as earnings subject to the self-employment tax. However, this provision was eliminated in the manager's amendment.	
Carried Interest	- No gain or loss is recognized to the extent that property held for investment purposes or for productive use in a taxpayer's trade or business is exchanged for property of a like-kind that is also held for investment purposes or for productive use in the taxpayer's trade or business. The like-kind exchange rules under IRC § 1031 apply to tangible real and personal property and certain intangible property.	- Carried interests would be subject to a three-year (rather than one-year) holding period requirement for long-term capital gains tax treatment.	- No change to current law.
Gain or Loss on a Sale or Exchange by a Foreign Person of an Interest in a Tax Partnership Engaged in a US Trade or Business	In *Grecian Magnesite Mining v. Comm'r*, the Tax Court concluded that gain or loss on a sale or exchange by a foreign person of an interest in a tax partnership that is engaged in a US trade or business would generally be treated as foreign-source.	- No change to current law.	- The Senate proposal would overrule *Grecian Magnesite*: - Gain or loss from the sale or exchange of a partnership interest would be ECI to the extent that the transferor would have had ECI had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. - The transferee of a partnership interest would be required to withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a foreign person (similar to the current FIRPTA regime).
Conversions of S Corporations into C Corporations	- Any distributions of earnings would be subject to the C corporation rules and, thus, treated as taxable dividends to the extent of the corporation's earnings and profits.	- Includes relief for S corporations converting to a C corporation within two years of the enactment of H.R. 1: (1) any income adjustments that arise from such a	- No change to current law.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
		conversion under IRC § 481 would be taken into account ratably over 6 years; (2) cash distributions from the converted S corporations would continue to be treated, generally for one year after conversion, as tax-free returns to the extent of the S corporation's accumulated adjustments account (AAA), and thereafter, as partially nontaxable in proportion to any remaining AAA compared to accumulated earnings and profits.	
INTERNATIONAL			
Anti-Base Erosion Provisions	- Foreign corporations are generally subject to US tax on a net basis on effectively connected income (ECI) under IRC § 882. - For certain non-ECI income that is fixed or determinable, annual or periodical (FDAP), a foreign corporation is subject to US taxation on a gross basis (30% statutory rate subject to reduction under a US tax treaty).	- Non-interest payments from a US corporation to a related foreign corporation that are deductible, includible in costs of goods sold, or includible in the basis of a depreciable or amortizable asset would generally be subject to a 20% excise tax, unless the related foreign corporation elected to treat the payments as ECI. - Would apply only to international financial reporting groups (IFRGs) with annual payments from US corporations to their foreign affiliates of at least $100 million. - Would be effective for tax years beginning after 2018. -Foreign tax credit would apply to 80% of foreign taxes. -Would eliminate the markup on deemed expenses. -The House bill includes a global thin capitalization rule.	- US corporations that are members of worldwide affiliated groups with domestic indebtedness would be limited in their ability to deduct interest paid or accrued. Specifically, interest paid or accrued by the corporation would be reduced by product of the net interest expense of the domestic corporation multiplied by the debt-to-equity differential percentage of the worldwide affiliated group. - Would impose a 20% tax on global intangible low-tax income (GILTI) of a US parent's controlled foreign corporations (CFCs). -Would revise the definition of intangible property under IRC § 936(h)(3)(B) to include workforce in place, goodwill, and going concern value. The basic approach of the existing transfer pricing rules with respect to income from intangible property would stay the same. -Would deny a deduction for any disqualified related party amount paid or accrued (1) pursuant to a hybrid transaction;

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
			(2) to a hybrid entity; or (3) by a hybrid entity. A disqualified related party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a US shareholder under section 951(a). - Would repeal special rules for domestic international sales corporations. - A shareholder who receives a dividend from a "surrogate foreign corporation" as defined under IRC § 7874(a)(2)(B) (provided it is not treated as a domestic corporation under IRC § 7874(b)) is not entitled to lower rates on qualified dividends provided in IRC § 1(h).
ESTATE TAX			
Estate Tax	- The exemption for the estate, gift, and generation-skipping transfer taxes is $5 million per individual ($5.49 million per individual in 2017, adjusted for inflation retroactively to 2011). The estate tax rate is 40%.	- Would double the exemption from the estate tax from $5 million to $10 million ($11.2 million in 2018, adjusted for inflation retroactively to 2011) and would repeal the estate tax completely on January 1, 2024. The basic exclusion amount for gift and generation-skipping transfers would also increase to $10 million ($11.2 million adjusted for inflation). The basis step up under IRC § 1014 for property received from a decedent at death would be retained even after the estate and	- Would double the estate, gift and generation-skipping transfer tax exemption from $5 million to $10 million (adjusted for inflation occurring after 2011) for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2017. - Does not include any provision for ultimate repeal of the estate, gift or generation-skipping transfer taxes.

	Current Law	House Bill (Passed by Ways & Means Committee)	Senate Bill (in Markup)
		generation skipping transfer taxes are repealed.	- Would maintain the current law basis step up under IRC § 1014 for property received from a decedent.



8 key differences between the dueling Senate and House tax bills

By **BERNIE BECKER** | 011/09/17 06:45 PM EDT

Politico.com

Congressional Republicans took two major steps on Thursday toward sending a tax bill to President Donald Trump's desk – the House Ways and Means Committee cleared its proposal on a party-line vote, and the Senate Finance Committee rolled out details of its tax plan.

But the release of the Senate details also illustrated just how much work the two chambers have left as they try to reconcile their differences in time for Trump to sign a tax bill this year. The Senate and the House have different proposals on a host of issues, ranging from individual and corporate tax rates to the deduction of state and local taxes.

1. Corporate tax rates

The top corporate rate of 35 percent applies to taxable income over $10 million a year. There are three other corporate tax brackets – 15 percent, 25 percent and 34 percent.

SENATE BILL

Cut the corporate tax rate to a permanent 20 percent, one year later.

The Senate would install a flat 20 percent corporate tax rate without an expiration date in 2019, after a one-year delay.

HOUSE BILL

Cut the corporate tax rate to a permanent 20 percent, immediately.

The House proposes a permanent 20 percent corporate tax rate that would go into effect in 2018.

2. Individual tax rates

There are seven individual tax rates – 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, 35 percent and 39.6 percent. There's also a standard deduction of $6,350 for single filers and $12,700 for married couples that helps create a de facto 0 percent bracket.

SENATE BILL

Keep the brackets at seven.

The Senate would keep the seven brackets, but generally with lower or equivalent rates – 10 percent, 12 percent, 22.5 percent, 25 percent, 32.5 percent, 35 percent and 38.5 percent. The thresholds for those rates have yet to be released. The standard deduction would be $12,000 for single filers and $24,000 for married couples.

HOUSE BILL

Collapsing to four.

The House proposes only four brackets, but keeps the top rate at 39.6 percent for income above $1 million a year for married couples. The other rates are 12 percent, 25 percent and 35 percent. The standard deduction would be $12,200 for single filers and $24,400 for married couples.

3. State and local taxes

Taxpayers who itemize can deduct both state and local income taxes and state and local property taxes.

SENATE BILL

Full elimination

The Senate, which doesn't have many Republicans in the high-tax states for which this deduction matters most, would eliminate taxpayers' ability to deduct both state and local income and property taxes.

HOUSE BILL

A compromise

The House proposal would allow taxpayers to deduct up to $10,000 in state and local property taxes, after Republicans from New York and New Jersey objected to a proposal to fully eliminate the deduction. Taxpayers could no longer deduct state and local income taxes.

4. Estate tax

Estates passed on to heirs face a top tax rate of 40 percent, with exemptions this year of up to $5.49 million for an individual and $10.98 million for a married couple. The exemption amount is indexed for inflation.

SENATE BILL

Double the exemption, and keep it that way.

The Senate proposes to double the current exemptions, to approximately $11 million for an individual and $22 million for a married couple, and continue to index the exemptions to inflation.

HOUSE BILL

Double the exemption, and then repeal.

The House proposes to double the current exemptions, to approximately $11 million for an individual and $22 million for a married couple – but only at first. The estate tax would then be repealed starting in 2025.

5. Mortgage interest deduction

Taxpayers can deduct interest payments on up to two mortgages, worth up to a combined $1 million.

SENATE BILL

No change.

The Senate would preserve the mortgage interest deduction.

HOUSE BILL

Slice it in half

The House proposes allowing taxpayers to deduct interest payments on mortgage balances for new homes of up to $500,000, and would not allow the deduction for second homes.

6. Deductions for student loan interest and medical expenses, and a credit for adoption expenses.

Eligible taxpayers can deduct up to $2,500 a year in interest on student loans. Eligible taxpayers can deduct, with some exceptions, medical expenses that exceed 10 percent of a taxpayer's adjusted gross income for a year. Eligible taxpayers can receive a maximum tax credit of $13,570 for qualified adoption expenses.

SENATE BILL

Keep them all.

The Senate preserves all three tax incentives, as well as a number of other individual tax preferences.

HOUSE BILL

Eliminate most of them.

The House tax bill would eliminate the deductions for medical expenses and student loan interest. The House measure originally proposed scrapping the adoption credit, but that provision was restored to the bill reported out of the Ways and Means Committee after objections from GOP lawmakers.

7. Child tax credit

Taxpayers may claim a $1,000 credit for each qualifying child under 17. The child credit begins to phase out at $75,000 of adjusted gross income for single taxpayers and $110,000 for married couples.

SENATE BILL

Slightly larger expansion

The Senate proposes to expand the credit from $1,000 per child to $1,650 – a figure still below the $2,000 sought by some GOP senators.

HOUSE BILL

Expansion

The House proposes expanding the credit to $1,600 per child, and includes a $300 credit for a taxpayer, his or her spouse and dependents who are not children under 17. The new family credit begins to phase out at $115,000 of adjusted gross income for individuals and $230,000 for married couples. The $300 credit is scheduled to expire after 2022.

8. Pass-through businesses

Business income from partnerships, S corporations and sole proprietorships is currently taxed at individual tax rates.

SENATE BILL

A deduction

The Senate would create a new deduction for so-called pass-through income that would set a top rate for those businesses in the low 30s – well above the 20 percent corporate rate

HOUSE BILL

Special rate

The House proposes a special 25 percent rate for pass-through income. But in many cases, only 30 percent of a business owner’s income would be eligible for that rate, with the other 70 percent classified as wage income. The House Ways and Means Committee most recently changed its bill to include lower tax rates for smaller pass-through businesses.

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Senate Finance Releases Tax Reform Proposal

November 10, 2017

Yesterday, the Senate released information on its tax reform proposal, which contains several differences from the bill reported out of the House yesterday. The Republican conference was briefed on the proposal yesterday morning and a description by the Joint Committee on Taxation of the Senate Finance Chairman's mark of the Tax Cuts and Jobs Act was released late last night. Significant differences include:

- Delaying the start of the corporate tax rate cut by one year, despite the Administration's "strong preference" for the cut to begin in 2018
- Keeping the number of tax brackets at seven instead of dropping it to four, and lowering the top tax bracket from 39.6% to 38.5%
- Eliminating the state and local tax deduction entirely (whereas the House would retain a deduction for property taxes up to $10,000)
- Maintaining the estate tax, while doubling the exclusion and
- Significant differences in the treatment of pass-throughs, taxation of foreign income and foreign persons, and the treatment of tax-exempt organizations.

As it stands now, the Senate proposal is intended to stay inside a $1.5 trillion cap on the spending, though it may require some additional changes to ensure it will not increase deficits outside the 10-year budget window to comply with the "Byrd Rule". The Senate is scheduled to begin a markup on Monday, November 13 at 3pm.

Major provisions of the Senate's proposal include:

BUSINESSES - GENERAL

- **Corporate Rate**
  - The Senate proposal reduces the corporate rate from 35% to 20%, effective for tax years beginning after 2018, with no sunset. This rate reduction is similar to the rate reduction proposed in the House bill, but would take effect one year later. The Senate proposal, like the House bill, also repeals the corporate alternative minimum tax.
  - The Senate proposal amends the dividends received deduction that applies to distributions from one corporation to another. Under current law, a corporation receives a 100% deduction for dividends received from another corporation in the same affiliated group, an 80% deduction for dividends received from a corporation in which it owns at least 20%, and a 70% deduction for dividends received from a corporation in which it owns less than 20%. Under the proposal, the 80% deduction would be reduced to 65% and the 70% deduction would be reduced to 50%. The House bill, as reported out of the Ways and Means Committee, contained the same reductions. The reductions are intended to align the dividends received deduction with the reduction in the corporate rate.
- **Pass-through Provisions**
  - The Senate's tax reform proposal contains several key differences from the House bill with respect to the treatment of pass-through businesses.

- Like the House bill, the Senate proposal:
  - Would limit like-kind exchange treatment under section 1031 to real property that is not held primarily for sale;
  - Would not make any technical changes to the new partnership audit and litigation regime scheduled to take full effect in 2018 (although such changes may be included as the proposal works its way through the legislative process); and
  - Would not make any changes to the self-employment tax regime for shareholders of S corporations and limited partners of limited partnerships (or equivalents).
    - Although a House proposal initially would have eliminated the preferential self-employment tax treatment for shareholders of S corporations and limited partners of limited partnerships, an amendment to the House bill removed this proposed change.
- The Senate proposal would generally allow an individual taxpayer to deduct 17.4% of "domestic" "qualified business income" from a partnership, S corporation, or sole proprietorship. This differs from the House bill, which would generally impose a 25% tax rate (with a 9% rate applying in certain cases) on qualified business income of individuals engaged in business activities through partnerships, S corporations, or sole proprietorships.
  - "Qualified business income" generally means the net amount of domestic qualified items of income, gain, deduction, and loss with respect to the taxpayer's qualified businesses (i.e., any trade or business other than specified service trades or businesses, except for a limited exception described below). There is no definition of "domestic."
  - Qualified business income of a taxpayer does not include:
    - Any amount paid by an S corporation that is treated as "reasonable compensation" of such taxpayer (no additional definition of reasonable compensation is provided);
    - Any amount allocated or distributed by a partnership to the taxpayer-partner who is acting other than in his or her capacity as a partner for services (section 707(a) service payments);
    - Any amount that is a guaranteed payment to the taxpayer-partner for services actually rendered to or on behalf of a partnership to the extent that the payment is in the nature of remuneration for those services (section 707(c) service payments); or
    - "Certain" investment-related income, gain, deductions, or loss (no additional definition of such investment items is provided).
  - The Joint Committee's description states "in the case of a taxpayer who has qualified business income from a partnership or S corporation, the amount of the deduction is limited to 50% of the W-2 wages of the taxpayer." It is unclear from this description how this limitation is intended to operate. For example, it might mean that, if a partner has any distributive share of qualified business income but no W-2 wages from such partnership (a rather typical situation), then such

partner would be ineligible for any such deduction (an outcome that would not exist under the House provisions). This also might mean that passive investors would be ineligible for any such deduction (as opposed to the House provisions that provide reduced tax rates for passive investors that have qualified business income). Instead, perhaps what is intended is that "the W-2 wages of the taxpayer" be determined with respect to the qualified business activities of the partnership and S corporation (rather than literally the W-2 wages received by the taxpayer partner/shareholder). In that case, each partner/shareholder would be allocated a proportionate share of such entities' W-2 wages that are paid to all employees of such entities, and then the 50% limitation would be applied at the partner/shareholder level based on allocated qualified business income and allocated W-2 wages from such entities.

    - The deduction generally does not apply to specified service businesses (i.e., any trade or business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees).
        - However, a broad exception exists in the case of any taxpayer to the extent his or her taxable income does not exceed $150,000. The benefit of a deduction for such taxpayers is phased out over a $50,000 range for taxable income exceeding $150,000. All such figures are for married individuals filing jointly; analogous figures are provided for other individuals. It is unclear how the taxable income phase-out is to operate vis-à-vis the deduction itself. Perhaps the phase-out will be determined without regard to the potential deduction.
    - The Senate has described this new deduction as "simple." It seems that neither the House's special tax rates on similar income nor this deduction approach from the Senate will be simple for taxpayers to apply or for the IRS to administer.
- Under the Senate proposal, "excess business losses" of a taxpayer other than a C corporation (generally, net losses in excess of $500,000) are not allowed for the taxable year, but rather are carried forward and treated as part of the taxpayer's net operating loss carryforward in subsequent taxable years. This proposal essentially disallows excess active net business losses, effectively extending the current treatment of net passive activity losses to active losses. There is no counterpart in the House bill.
    - An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer, over the sum of "aggregate gross income or gain" of the taxpayer plus a threshold amount. For married taxpayers filing jointly, such threshold amount is $500,000. The term "aggregate gross income or gain" is not qualified by "attributable to trades or businesses of the taxpayer," which suggests that such business deductions would need to exceed all types of income or gain (including passive and portfolio) before such net amount became subject to the loss limitation.
    - In the case of a partnership or S corporation, the proposal applies at the partner or shareholder level.

- The Senate proposal would overrule *Grecian Magnesite Mining v. Commissioner* and codify Revenue Ruling 91-32. There is no counterpart in the House bill.
  - In Revenue Ruling 91-32, the IRS adopted an “aggregate theory” approach, holding that the gain realized by a foreign partner on the sale or disposition of its interest in a partnership engaged in a trade or business through a fixed place of business in the United States should be analyzed at the partnership level and on an asset by asset basis, and that, to the extent there would be effectively connected income (ECI) with respect to such asset sales, the selling partner’s pro rata share of such gain should be treated as ECI.
  - In *Grecian Magnesite*, the Tax Court disagreed with this approach and concluded that the relevant Code and regulatory provisions did not support the use of the aggregate theory of partnerships in these types of cases. Instead, the court concluded that an entity theory of partnerships was more appropriate, and, therefore, there should be no “look-through” applied. Consequently, gain or loss on a sale or exchange by a foreign person of an interest in a tax partnership that is engaged in a US trade or business would generally be treated as foreign-source.
  - Under the Senate proposal, gain or loss from the sale or exchange of a partnership interest is effectively connected with a US trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. Any gain or loss from the hypothetical asset sale by the partnership would be allocated to interests in the partnership in the same manner as non-separately stated income and loss.
  - Additionally, under the proposal, the transferee of a partnership interest must withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation. Such proposal appears to share some similarities to the current FIRPTA withholding/reporting regime.
- The Senate proposal would expand the definition of a substantial built-in loss for purposes of section 743(d). There is no counterpart in the House bill.
  - Under current law, a partnership generally does not adjust the basis of partnership property following a transfer of a partnership interest. However, if the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner to account for the difference between the transferee partner’s proportionate share of the adjusted basis of the partnership property and the transferee’s basis in its partnership interest. A substantial built-in loss exists if the partnership’s adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property.
  - The Senate proposal would provide that a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all of the partnership’s assets in a fully taxable transaction for cash equal to the assets’ fair market value, immediately after the transfer of the partnership interest.

- The Senate proposal modifies the section 704(d) outside basis limitation on partner losses to provide that generally a partner's distributive share of charitable contributions and foreign tax expenditures are allowed only to the extent of the partner's outside basis at the end of the partnership taxable year in which the expenditure occurs. There is no counterpart in the House bill.
  - Under current law, in applying the section 704(d) outside basis limitation on partner losses, Treasury regulations do not take into account the partner's share of partnership charitable contributions and foreign taxes paid or accrued, which effectively permits such items to be taken into account by partners regardless of whether they have tax basis in their partnership interests.
- The Senate proposal does not contain any specific changes to the treatment of carried interest, although the issue may be addressed in markup. An amendment to the House bill would impose with respect to partnership interests received in connection with performing certain management services a three-year holding period requirement for allocable gain from partnership assets to be eligible for long-term capital gain tax rates (essentially increasing the relevant holding period for the assets generating such gain from 1 year to 3 years).
- The Senate proposal does not make any specific changes to the S corporation rules. An amendment to the House bill includes provisions that would provide relief of S corporations that convert to C corporations within two years of the enactment of the tax reform legislation.
- Unlike the House bill, the Senate proposal does not repeal the partnership technical termination rule.

- **International Provisions**
  - The international provisions in the Senate's initial tax reform plan (as described in the Joint Committee on Taxation's summary) contain similarities and differences from those included in the House's final tax reform bill. Both the Senate's and House's versions propose moving toward a territorial tax system (specifically, through the adoption of a dividend-exemption system), but the base erosion mechanisms are different.
  - **Dividend-Exemption System.**
    - The Senate proposal provides for a 100% deduction for the foreign-source portion of dividends received from specified 10% owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b) (referred to in the proposal as DRD). No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD. There are also provisions addressing hybrid dividends, holding periods, and sales or transfers.
    - The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of US shareholders in which or with which such taxable years of foreign corporations end.
  - **Tax on Deferred Foreign Income Upon Transition to Dividend-Exemption System.**
    - The proposal generally requires that, for the last taxable year beginning before January 1, 2018, any US shareholder of a specified foreign corporation must include in income its pro rata share of the undistributed, non-previously-taxed

post-1986 foreign earnings of the corporation, generally determined as of November 9, 2017 ("mandatory inclusion"). Generally, the tax on the aggregate earnings and profits attributable to cash assets is 10%, while the tax on aggregate earnings and profits attributable to other assets is 5%. These rates are lower than the rates in the House bill (14% and 7%). A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The increased tax liability generally may be paid over an eight-year period (without interest).

    - For purposes of this proposal, a specified foreign corporation is any foreign corporation that has at least one US shareholder. It does not include PFICs that are not also CFCs.

- **Current Year Inclusion of Global Intangible Low-Taxed Income by United States Shareholders.**
    - Under the proposal, a US shareholder of any CFC must include in gross income for a taxable year its global intangible low-taxed income (GILTI) in a manner generally similar to inclusions of subpart F income. GILTI means, with respect to any US shareholder for the shareholder's taxable year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return is an amount equal to 10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment ("QBAI") of each CFC with respect to which it is a US shareholder. This is the Senate version of the House "foreign high returns" proposal.
    - The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of US shareholders in which or with which such taxable years of foreign corporations end.
- **Deduction for Foreign-Derived Intangible Income.**
    - In the case of a domestic corporation, the proposal allows (for the corporation's taxable year) a deduction equal to 37.5% of the lesser of (1) the sum of its foreign-derived intangible income plus the amount of GILTI that is included in its gross income, or (2) its taxable income, determined without regard to this proposal. The foreign-derived intangible income of any domestic corporation is the amount which bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction eligible income bears to its deduction eligible income. The Secretary is authorized to prescribe regulations or other guidance as may be necessary or appropriate to carry out this proposal.
    - The proposal is effective for taxable years beginning after December 31, 2017.
- **Special Rules for Transfers of Intangible Property from Controlled Foreign Corporations to United States Shareholders.**
    - The Senate proposal includes a provision to allow intangible property to be transferred back to the United States without incurring US tax. For certain distributions of intangible property held by a CFC on the date of enactment of this proposal, the fair market value of the property on the date of the distribution is treated as not exceeding the adjusted basis of the property immediately before the distribution. If the distribution is not a dividend, a US shareholder's adjusted

basis in the stock of the CFC with respect to which the distribution is made is increased by the amount (if any) of the distribution that would, but for this proposal, be includible in gross income. The adjusted basis of the property in the hands of the US shareholder immediately after the distribution is the adjusted basis immediately before the distribution, reduced by the amount of the increase (if any) described previously.

- For purposes of the proposal, intangible property means intangible property as described in section 936(h)(3)(B) and computer software as described in section 197(e)(3)(B).
- The proposal applies to distributions that are (1) received by a domestic corporation from a CFC with respect to which it is a US shareholder and (2) made by the CFC before the last day of the third taxable year of the CFC beginning after December 31, 2017.
- The proposal is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of US shareholders in which or with which such taxable years of foreign corporations end.

- **Other Modifications to Subpart F Provisions.**
  - The proposal eliminates foreign base company oil related income as a category of foreign base company income. A similar provision was in the House bill reported out of committee.
  - In the case of any taxable year beginning after 2017, the proposal indexes for inflation the $1,000,000 *de minimis* amount for foreign base company income, with all increases rounded to the nearest multiple of $50,000. A similar provision was in the House bill reported out of committee.
  - The proposal repeals section 955. As a result, a US shareholder in a CFC that invested its previously excluded subpart F income in qualified foreign base company shipping operations is no longer required to include in income a pro rata share of the previously excluded subpart F income when the CFC decreases such investments. A similar provision was in the House bill reported out of committee.
  - The proposal amends the ownership attribution rules of section 958(b) so that certain stock of a foreign corporation owned by a foreign person is attributed to a related US person for purposes of determining whether the related US person is a US shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC. In other words, the proposal provides "downward attribution" from a foreign person to a related US person in circumstances in which present law does not so provide. The pro rata share of a CFC's subpart F income that a United States shareholder is required to include in gross income, however, continues to be determined based on direct or indirect ownership of the CFC, without application of the new downward attribution rule. A similar provision was in the House bill reported out of committee.
  - The proposal expands the definition of US shareholder under subpart F to include any US person who owns 10% or more of the total value of shares of all classes of stock of a foreign corporation. (Current law requires 10% or more of the total combined voting power.)

  - The proposal eliminates the requirement that a corporation must be controlled for an uninterrupted period of 30 days before subpart F inclusions apply. A similar provision was in the House bill reported out of committee.
  - The proposal makes permanent the exclusion from foreign personal holding company income for certain dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC. A similar provision was in the House bill reported out of committee.
  - The requirement in subpart F that US shareholders recognize income when earnings are repatriated in the form of increases in investment by a CFC in US property is amended to provide an exception for domestic corporations that are US shareholders in the CFC either directly or through a domestic partnership. The House bill reported out of committee would repeal section 956 entirely.
- **Anti-Base Erosion Measures.**
  - Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness.
    - The proposal limits the deductibility of interest paid or accrued by US corporations that are members of a worldwide affiliated group. For any domestic corporation that is a member of a worldwide affiliated group, the proposal reduces the deduction for interest paid or accrued by the corporation by the product of the net interest expense of the domestic corporation multiplied by the debt-to-equity differential percentage of the worldwide affiliated group. A global thin capitalization rule was also included in the House bill reported out of committee.
    - The proposal is effective for taxable years beginning after December 31, 2017.
  - Limitations on income shifting through intangible property transfers.
    - The proposal addresses recurring definitional and methodological issues that have arisen in controversies involving transfers of intangible property for purposes of sections 367(d) and 482, both of which use the statutory definition of intangible property in section 936(h)(3)(B). The proposal revises that definition to include workforce in place, goodwill, and going concern value. The proposal also confirms the authority to require certain valuation methods. It does not modify the basic approach of the existing transfer pricing rules with regard to income from intangible property.
    - The proposal applies to transfers in taxable years beginning after December 31, 2017. No inference is intended with respect to application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application on or before the date of enactment.
  - Denial of deduction for any certain related party amounts paid or accrued in hybrid transactions or with hybrid entities.
    - The proposal denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity. A disqualified related party amount is any interest or royalty

paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a US shareholder under section 951(a). A related party for these purposes is generally determined under the rules of section 954(d)(3).

- The proposal is effective for taxable years beginning after December 31, 2017.

- Termination of special rules for domestic international sales corporations.
  - The proposal repeals the special rules for DISCS and IC-DISCS and includes a transition rule for shareholders of corporations the DISC elections of which are terminated. The proposal is effective for taxable years beginning after December 31, 2018.
- Surrogate foreign corporations not eligible for reduced rate on dividends.
  - Any individual shareholder who receives a dividend from a corporation which is a surrogate foreign corporation as defined in section 7874(a)(2)(B), other than a foreign corporation which is treated as a domestic corporation under section 7874(b), is not entitled to the lower rates on qualified dividends provided for in section 1(h). The proposal is effective for dividends paid in taxable years beginning after December 31, 2017.

- **Modifications to Foreign Tax Credit System.**
  - Repeal of section 902 indirect foreign tax credits and the determination of section 960 credit on current-year basis.
    - The proposal repeals the deemed-paid credit with respect to dividends received by a domestic corporation which owns 10% or more of the voting stock of a foreign corporation. A deemed-paid credit is provided with respect to any income inclusion under subpart F. The deemed-paid credit is limited to the amount of foreign income taxes properly attributable to the subpart F inclusion. The proposal eliminates the need for computing and tracking cumulative tax pools. A similar provision was in the House bill reported out of committee.
  - Separate foreign tax credit limitation basket for foreign branch income.
    - The proposal requires foreign branch income to be allocated to a specific foreign tax credit basket. Foreign branch income is the business profits of a US person which are attributable to one or more QBUs in one or more foreign countries. Under this proposal, business profits of a QBU shall be determined under rules established by the Secretary. Business profits of a QBU shall not, however, include any income which is passive category income.
    - The proposal is effective for taxable years beginning after December 31,

2017.

- Acceleration of election to allocate interest on a worldwide basis.
  - This proposal accelerates the effective date of the worldwide interest allocation rules to apply to taxable years beginning after December 31, 2017, rather than to taxable years beginning after December 31, 2020.
- Source of income from sales of inventory determined solely on basis of production activities.
  - Under this proposal, gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the United States is allocated and apportioned on the basis of the location of production with respect to the property. Likewise, income derived from inventory property sold in the United States, but produced entirely in another country, is sourced in that country even if title passage occurs in the United States. If the inventory property is produced partly in, and partly outside, the United States, however, the income derived from its sale is sourced partly in the United States. A similar provision was in the House bill reported out of committee.
  - The proposal is effective for taxable years beginning after December 31, 2017.

○ **Base Erosion Minimum Tax.**

- Under the proposal, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. In general, the base erosion minimum tax amount means, with respect to an applicable taxpayer for any taxable year, the excess of 10% of the modified taxable income of the taxpayer (generally, taxable income adding back deductible payments to foreign affiliates, to the extent not subject to full withholding) for the taxable year over an amount equal to the regular tax liability of the taxpayer for the taxable year reduced (but not below zero) with certain adjustments for credits. In sum, the base erosion tax would equal 10% of the excess of deductible payments to foreign affiliates over the taxable income of the US payor computed with regard to the deductible payments.
- An applicable taxpayer means, with respect to any taxable year, a taxpayer: (A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (B) which has average annual gross receipts of at least $500 million for the three-taxable-year period ending with the preceding taxable year; and (C) which has a base erosion percentage (generally, deductible payments to foreign affiliates divided by total allowable deductions) of 4% or higher for the taxable year.
- The proposal introduces additional reporting requirements under section 6038A. The penalties provided for under sections 6038A(D)(1) and (2) are both increased to $25,000.
- The proposal applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

○ **Other Provisions.**

- The proposal creates a category of income defined as passenger cruise gross income, provides rules for determining the extent to which such income is effectively connected to a US trade or business, and removes such income from eligibility for the reciprocal exemption of section 883. The proposal is effective for taxable years beginning after December 31, 2017.
- The proposal modifies the PFIC rules for determining active income of a foreign corporation engaged in insurance activities by replacing the test based on whether a corporation is predominantly engaged in an insurance business with a test based on the corporation's insurance liabilities. The requirement that the foreign corporation would be subject to tax under subchapter L if it were a domestic corporation is retained. The proposal applies to taxable years beginning after December 31, 2017. The House bill reported out of committee contains a similar provision addressing the PFIC insurance rules.
- The proposal prohibits members of a US affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of section 864(e). Instead, the members must allocate interest expense based on the adjusted tax basis of assets. The proposal is effective for taxable years beginning after December 31, 2017.

- **Business Deductions**
  - **Interest**. Under the Senate proposal, the amount of net interest that can be deducted by any business with gross receipts of $15 million or more is generally limited to 30% of the adjusted taxable income for the year. Adjusted taxable income means the taxable income of the taxpayer computed without regard to: (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the 17.4% deduction for certain pass-through income; and (4) the amount of any net operating loss deduction. The limitation does not apply to certain regulated public utilities. In addition, the trade or business of performing services as an employee is not treated as a trade or business for purposes of the limitation. Also, at the taxpayer's election, any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing or brokerage trade or business is not treated as a trade or business for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses. The amount of any business interest not allowed as a deduction may be carried forward and used as a deduction in a subsequent year. If the limitation on deduction of interest by a domestic corporation that is a member of a worldwide affiliated group with excess domestic indebtedness would also apply, then whichever rule imposes the lower limitation controls. This proposal is similar in certain respects to the interest deduction limitation proposed in the House bill, but with important differences. The gross receipts threshold is lower in the Senate proposal. In addition, the definition of "adjusted taxable income" in the Senate proposal is different than in the House bill. The Senate proposal does not include amortization, depreciation, or depletion (i.e., it uses EBIT instead of EBITDA for the computation).
  - **Net Operating Losses**. The Senate proposal limits the net operating loss deduction to 90% of taxable income, consistent with the rule that applies under the current law alternative minimum tax. The proposal repeals the two-year carryback and special carryback provisions, but provides an exception for certain farming losses. This provision

is similar to the net operating loss provision in the House bill.

- **Depreciation and Expensing**. Under the Senate proposal, the 50% bonus depreciation under current law is increased to 100% through 2022 (through 2023 for longer production period property and certain aircraft). The proposal generally applies to property placed in service after September 27, 2017, and to specified plants planted or grafted after such date. There is a transition rule that allows a taxpayer to elect to apply a 50% allowance for the first taxable year ending after September 27, 2017. This provision is similar to the 100% provision in the House bill, but is broader.
- **Recovery Period for Real Property**. The Senate proposal also includes an additional provision that would shorten the recovery period for determining the depreciation deduction with respect to nonresidential real and residential rental property to 25 years. There is no corresponding provision in the House bill.
- **Like-Kind Exchanges**. The Senate proposal would limit like-kind exchanges under section 1031 to exchanges of real property. The proposal includes a transition rule to allow like-kind exchanges for personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017. This proposal is the same as the proposal on like-kind exchanges in the House bill.

INSURANCE COMPANIES

- **Life Insurance Companies**
  - The provisions concerning life insurance companies in the Senate proposal substantially mirror the unamended original House bill, including changes with respect to net operating losses, repeal of the small life insurance company deduction, adjustments for change in computing reserves, and repeal of the special rule for distributions to shareholders from pre-1984 policyholders surplus accounts.
- **Non-life Insurance Companies**
  - The proposal amends section 832 to provide that, for proration purposes, the reduction in the losses incurred deduction attributable to tax-exempt interest and the dividends received deduction is increased from 15% to an amount equal to 5.25% divided by the top corporate tax rate. A similar provision was included in the House bill but with a different percentage calculation.
  - The proposal amends section 848 to extend the amortization period for specified policy acquisition expenses from a 120-month period to a 600-month period. The proposal does not change the special rule providing for 60-month amortization of the first $5 million of specificied policy acquisition expenses (with phaseout). The proposal provides that for annuity contracts, the percentage is 3.17; for group life insurance contracts, the percentage is 3.72; and for all other specified insurance contracts, the percentage is 13.97.
  - As in the House bill, the proposal repeals section 847 and the special estimated tax payment rules related to the difference between discounted and undiscounted reserves.

COMPENSATION AND RETIREMENT SAVINGS

- **Compensation**

- The Senate proposal repeals section 409A governing deferred compensation for services performed after December 31, 2017, by adding a new section 409B. The effect of the repeal of section 409A is to cause compensation to be immediately taxable upon the lapse of a substantial risk of forfeiture (i.e., upon vesting). Unlike current law, the new Senate proposal causes stock options and stock appreciation rights (SARs) to become immediately taxable upon vesting. Vesting is redefined as time vesting, thereby excluding vesting based on achievement of performance goals. The repeal essentially eliminates the efficacy of stock options and SARs, while retaining the current law rules for incentive stock options and section 423 employee stock purchase plans. Under the new rule, a substantial risk of forfeiture is based only upon the performance of future services, eliminating the concept of vesting after separation of service. Transfers of property under section 83 are unaffected by the Senate proposal (except regarding non-qualified options). The Senate proposal preserves the short-term deferral rule and provides a transition rule for amounts deferred prior to 2018. The House bill originally contained a similar repeal of section 409A, but it was restored in the House bill by amendment. The House bill also allowed an election under a new section 83(i) for broad-based deferred compensation plans for non-public companies, but this provision is not included in the Senate proposal.
- The Senate proposal repeals the special deferred compensation rules for executives of tax-exempt organizations under section 457(f), making such compensation subject to the new section 409B, and repeals the rules applicable to deferred compensation of tax indifferent entities under section 457A. The Senate proposal also would change the contribution limits applicable to eligible deferred compensation plans under section 457(b).
- The Senate proposal contains the House bill's changes to the $1 million deduction cap on public company executive compensation under section 162(m). The change includes commissions and performance-based compensation in the calculation of the $1 million cap, thereby discouraging excess compensation, and changes the executives to whom section 162(m) applies. Under current law, section 162(m) provides for the exclusion of commissions and performance-based compensation from the $1 million cap.
- The Senate proposal, like the House bill, includes a new 20% excise tax on tax-exempt organizations for paying compensation to certain highly compensated employees in excess of $1 million, including, for example, coaches at public colleges and universities. Additionally, a new 20% excise tax similar to the "parachute tax" under section 280G applies to a tax-exempt organization that pays certain executives excess amounts that are contingent upon a separation from employment, rather than upon a change in control.

- **Retirement Savings**
  - The proposal includes none of the retirement savings provisions included in the House bill, such as changes to in-service distributions, hardship distributions, loan rollovers and nondiscrimination testing. Nor does the proposal subject governmental pension plans and other entities to the unrelated business income tax (UBIT) rules as the House bill did.
  - The proposal would coordinate the limits for governmental section 457(b) plans with the limits for section 401(k) and 403(b) plans so that the same limits apply to elective deferrals and catch-up contributions under section 401(k) plans, section 403(b) plans, and governmental section 457(b) plans. The proposal would also revise application of the limit on aggregate contributions so that a single aggregate limit applies to contributions

for an employee to any defined contribution plan, section 403(b) plan, and any governmental section 457(b) plan maintained by the same employer.

- The proposal would repeal the special rules allowing additional elective deferrals and catch-up contributions under section 403(b) plans and governmental section 457(b) plans, and would repeal the special rule allowing employer contributions to section 403(b) plans for up to five years after termination of employment.
- Under the proposal, the 10% early withdrawal tax that applies to most employer-sponsored retirement plans would become applicable to a distribution from a governmental section 457(b) plan before age 59½, to the extent the distribution is includible in income.
- The proposal would eliminate catch-up contributions for high wage earners. Under the proposal, an employee could not make catch-up contributions for a year in which the employee received wages of $500,000 or more for the preceding year.
- The retirement provisions would be effective for plan years and taxable years beginning after December 31, 2017.

- **Worker Classification**
  - The Senate proposal addresses the confusing worker classification rules under current law for distinguishing between common law employees and independent contractors for tax purposes. The House bill contained no similar provision. The Senate proposal would establish a safe harbor based on specific requirements, such as whether the worker generally (1) incurs expenses deductible as trade or business expenses and is reimbursed for most such expenses; (2) agrees to work for a particular amount of time, to achieve a specific result, or to complete a specific task; and (3) has a significant investment in the assets or training related to the services, not be required to perform services exclusively for the entity receiving the services, or has not performed substantially the same services as an employee of the service recipient during the prior year; and not be compensated based primarily on hours actually worked. If these requirements are satisfied and the parties enter into a contract that satisfies certain conditions, the safe harbor provides that the worker is not treated as an employee of the entity receiving the services or of the entity charged with paying the worker; neither such entity is treated as the worker's employer, and the compensation received by the worker is not treated as pay for employment. The safe harbor means that the worker could be classified as an independent contractor, rather than an employee, of service recipients and third-party payors.

INDIVIDUALS

- **Individual Rates and Standard Deduction**
  - While the House plan had four individual tax rates, the Senate plan has seven tax brackets: 10, 22, 22.5, 25, 32.5, 35 and 38.5%. The highest individual tax rate of 38.5% would apply to individual taxpayers with incomes over $500,000 and married couples with over $1 million in annual income.
  - As in the House bill, the standard deduction is increased to $12,000 for individuals and $24,000 for married couples.
- **State and Local Tax Deduction**

    - The proposal fully eliminates the deduction for state and local taxes. The Senate plan does not include an exception for state and local property taxes.

- **Mortgage Interest Deduction**
    - The Senate proposal generally would keep the mortgage interest deduction as it stands under current law.
- **Child Tax Credit**
    - The child tax credit is increased to $1,650 from $1,000 per qualifying child. Additionally, the age limit for a qualifying child is increased by one year to include children under 18.
    - The proposal includes an additional $500 credit for non-dependent children, as compared to $300 under the House bill.
    - The threshold at which the credit begins to phase out is increased to $1 million for married taxpayers filing a joint return and $500,000 for all other taxpayers.
    - The Senate proposal does not include the new family flexibility credit proposed by the House.
- **Estate Tax**
    - The Senate proposal doubles the estate, gift and generation-skipping transfer tax exemption from $5 million to $10 million (adjusted for inflation occurring after 2011) for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2017.
    - The Senate proposal does not include any provision for ultimate repeal of the estate, gift or generation-skipping transfer taxes.
    - The Senate proposal would maintain the current law basis step up under section 1014 for property received from a decedent at death.

EXEMPT ORGANIZATIONS

- As with the House bill, the Senate bill would leave the charitable contribution deduction in place as an itemized deduction, and no "universal" or "above-the-line" deduction is included in the bill. In addition, the increase in the standard deduction, limitations on and repeal of several itemized deductions, and the increase in the estate tax exemption in the Senate bill are expected to reduce the incentive provided by the charitable contribution deduction. The Senate bill also retains the excise taxes on net investment income from private college and university endowments and on certain executive compensation paid by tax-exempt organizations, among other provisions affecting tax-exempt organizations included in the House bill.

- The Senate bill includes a number of significant changes to the intermediate sanctions rules under section 4958 (excise tax on excess benefit transactions):

    - The Senate bill would impose a 10% excise tax on the tax exempt organization (in addition to the existing taxes on disqualified persons and the organization's managers), unless the organization establishes that the minimum standards of due diligence were met with respect to the transaction or that other reasonable procedures were used to ensure that no excess benefit was provided.

- In addition, the Senate bill would eliminate the rebuttable presumption of reasonableness with respect to compensation arrangements and property transfers.

- Under the proposal, the procedures that presently provide an organization with a presumption of reasonableness generally will establish instead that an organization has performed the minimum standards of due diligence. Consequently, such procedures would only avoid penalties on the organization and not on the disqualified person or organization managers.

- The proposal eliminates the special rule that provides that an organization manager's participation ordinarily is not "knowing" for purposes of the intermediate sanctions excise taxes if the manager relied on professional advice, rather such reliance is one of the factors to be considered.

- The proposal modifies the definition of a disqualified person for purposes of the intermediate sanctions rules to include certain investment advisors and athletic coaches.

- The proposal extends application of the section 4958 intermediate sanctions rules to tax-exempt organizations described in sections 501(c)(5) (labor and certain other organizations) and 501(c)(6) (business leagues and certain other organizations).

- The Senate bill includes a number of other provisions affecting tax-exempt organizations that were not in the House bill, including:

  - A provision that generally subjects any sale or licensing by an organization of any name or logo of the organization (including any trademark or copyright related to a name or logo), and the royalties derived from any such licensing, to the unrelated business income tax (UBIT) provisions.

  - A requirement that UBTI first be computed separately with respect to each separate unrelated trade or business so that deductions from one such trade or business generally will not be able to offset income from another trade or business.

  - A repeal of the tax-exempt status for professional football leagues as section 501(c)(6) organizations, and extends such exclusion to all professional sports leagues.

  - The original House bill included a repeal of the rules for deferred compensation for tax-exempt organization employees under sections 457(f), 457(b), and 457A with respect to services performed after December 31, 2017. This repeal was removed from the original House bill by amendment during the markup process. However, the Senate bill generally has retained this repeal from the original House bill.

- The Senate bill also omits a number of provisions affecting tax-exempt organizations contained in the House bill, including:

  - A provision permitting 501(c)(3) organizations, including churches and certain related organizations, to make statements relating to political candidates in the ordinary course of exempt activities, provided the organization incurred only *de minimis* incremental expenses.

- A simplification of the current two-tier private foundation excise tax on investment income to be replaced by a flat 1.4% excise tax.

- The termination of the tax preference for private activity bonds, including qualified 501(c)(3) bonds, tax credit bonds, and bonds used to finance professional sport stadiums.

- The repeal of the controversial option in section 170(f)(8)(D) under which the IRS currently may allow donee organizations to report charitable contributions to the IRS instead of sending a contemporaneous acknowledgement to the donor.

- A clarification that UBIT rules apply to "dual-status" organizations, which are also exempt under provisions of the code other than section 501.

- Other changes to UBIT, including an inclusion of certain fringe benefits (qualified transportation, qualified parking, and on-premises athletic facilities) provided to employees of tax-exempt organizations in the computation of UBTI and narrowing of the UBIT exclusion for research income, limiting its application to income from research that is freely available to the public.

- A limited exception to the excess business holding rules for private foundations that would be created for certain wholly-owned and independently operated businesses where all net operating income promptly is distributed for use in the foundation's charitable purposes.

- Additional reporting requirements for donor advised fund sponsoring organizations.

- A provision providing that an organization that operates an art museum as a substantial activity will not qualify as a private operating foundation unless the museum is open during normal business hours to the public for at least 1,000 hours per year.

- An adjustment for the amount deductible for use of a passenger automobile for charitable purposes from the current fixed 14 cents per mile, to an amount that reflects the current variable cost of operating an automobile (as is currently used to calculate the medical and moving expense deductions).