Conference Committee Tax Bill Released

December 16, 2017

Yesterday, the House and Senate Conference Committee released the Conference Agreement, including statutory language for the GOP's tax reform bill and a Joint Explanatory Statement. The Conference Agreement generally follows the Senate amendment of the House bill with a number of changes.

Both the Senate and the House are scheduled to vote on the Conference Agreement early next week, with the Senate expected to vote first to ensure the bill meets all the Senate rules before moving to the House. The Conference Agreement cannot be amended, except for provisions that violate the budget reconciliation requirements.

The bill will cost $1.46 trillion, according to an estimate from the Congressional Budget Office and the Joint Committee on Taxation.

Major provisions of the legislation include:

BUSINESSES - GENERAL

- **Corporate**
  - **Rate.** The Conference Agreement reduces the corporate rate from 35% to 21%, effective for tax years beginning after 2017, with no sunset. This follows the House and Senate bills, but increases the corporate rate from 20% to 21%.
  - **Alternative Minimum Tax (AMT).** The Conference Agreement follows the House bill and repeals the corporate AMT.
  - **Dividends Received Deduction.** The Conference Agreement follows the House and Senate bills and 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 Conference Agreement, the 80% deduction would be reduced to 65% and the 70% deduction would be reduced to 50%. The reductions are intended to align the dividends received deduction with the reduction in the corporate rate.
  - **Capital Contributions.** The Conference Agreement follows the House bill and includes a provision that revises the definition of contribution to capital. Unlike the House bill, however, the Conference Agreement does not repeal section 118, the provision under which, generally, a corporation's gross income does not include contributions to capital. Rather, it provides that the term "contributions to capital" in section 118 does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such). The Conference Agreement also retains section 108(e)(6), which permits tax-free contributions of debt to capital by creditors. The provision is effective for contributions after the date of enactment except for contributions made by a government entity pursuant to certain master development plans. The Conference Agreement also makes clear that section 118 applies only to corporations.
- **Pass-throughs**

- The Conference Agreement largely follows the deduction approach in the original Senate bill, with certain modifications. The Conference Agreement reduces the deduction rate from 23% to 20% and reduces the threshold amount above which both the limitation on specified service businesses and the wage limit are phased in from $500,000 for joint filers ($250,000 for single filers) to $315,000 for joint and $157,500 for single. The conferees reduced the threshold amount in an effort to deter high-income taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20% deduction.
  - The Conference Agreement generally allows a taxpayer "other than a corporation" a deduction in an amount equal to the combined qualified business income (QBI) amount for the taxable year, which is equal to the sum of (1) the deductible amounts determined for each qualified trade or business carried on by the taxpayer and (2) 20% of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income.
  - In the partnership and S corporation context, the rules generally apply at the partner and shareholder levels. The provision has been expanded from the original House and Senate bills to permit trusts and estates to take the deduction.
  - QBI is defined, on a business-by-business basis, as the net amount of qualified items of income, gain, deduction, and loss with respect to a qualified trade or business of the taxpayer. If the net amount of such qualified items of income, gain, deduction, and loss with respect to a qualified trade or business of the taxpayer for any taxable year is less than zero, that amount is treated as a loss from a qualified trade or business in the succeeding taxable year.
    - "Qualified items of income, gain, deduction, and loss" generally include all business income other than investment income (generally dividends, investment interest income, short-term capital gains, long-term capital gains, commodities gains, foreign currency gains). Unlike the original House bill, such income is limited only to QBI that is effectively connected with the conduct of a U.S. trade or business (applying pre-existing international tax rules for such standard).
    - "Qualified trade or business" means any trade or business other than a specified service business or the trade or business of performing services as an employee.
  - The deductible amount for each qualified trade or business is the **lesser of** (1) 20% of the taxpayer's QBI with respect to the trade or business, or (2) the **greater of** (a) 50% of the W-2 wages with respect to the trade or business or (b) the sum of 25% of the W-2 wages with respect to the trade or business and a capital component (2.5% of the unadjusted basis, immediately after acquisition, of all qualified property).
    - The W-2 wage limit does not apply in the case of a taxpayer with taxable income not exceeding $315,000 for joint filers or $157,500 for all other taxpayers. The W-2 wage limit is then phased in for taxpayers with taxable income exceeding $315,000/$157,500 over the next $100,000 of taxable income for joint filers or $50,000 for all other taxpayers (i.e., full

W-2 limitation applies at $415,000/$207,500). For this limit, taxable income is determined without regard to the deduction itself, and the thresholds will be inflation adjusted.

- Qualified property means tangible depreciable property held by, and available for use in, the qualified trade or business at the close of the taxable year, and which is used in the production of QBI, and for which the "depreciable period" has not ended before the close of the taxable year. The "depreciable period" with respect to qualified property generally means the greater of 10 years or the applicable depreciation period for such property.

- QBI does not include any amount paid to the relevant taxpayer (such as from an S corporation) that is treated as reasonable compensation (as determined under current law), nor does it include any amount paid by a partnership that is a guaranteed payment under section 707(c) or a section 707(a) payment for services.

- The deduction is also generally not available for specified service businesses. However, an exception is provided for taxpayers under a certain income threshold ($315,000 joint, $157,500 for all other taxpayers). The exception is phased out for taxpayers with taxable income exceeding $315,000/$157,500 over the next $100,000 of taxable income for joint filers or $50,000 for all other taxpayers (i.e., full specified service business limitation applies at $415,000/$207,500). For this limit, taxable income is determined without regard to the deduction itself, and the thresholds will be inflation adjusted.

    - The definition of specified service businesses has been modified from both the House and Senate bills. It has been narrowed in that engineering and architectural businesses are not automatically included in such definition. It has been expanded in that the reputation and skill of "owners" (not just "employees") are included in determining whether a business' principal asset is the reputation or skill of one or more persons.

    - The definition now effectively encompasses any trade or business involving the performance of services in the fields of health, law, 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 or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities.

- The deduction applies to publicly-traded partnership income (and any ordinary income from disposition of units therein), with the added benefit that the W-2 wage limits do not apply in this respect. The specified service business limit continues to apply however.

- The deduction also applies generally with respect to specified agricultural or horticultural cooperative income.

        - The Conference Agreement clarifies that the deduction does not reduce adjusted gross income, and it can be taken by taxpayers, regardless whether they itemize or take the standard deduction. However, the deduction cannot exceed the taxable income of the taxpayer (after reduction for qualified capital gain).
        - The deduction is not added back for purposes of the individual AMT.
        - The deduction sunsets after December 31, 2025.
    - The Conference Agreement follows the original Senate bill by imposing a three-year holding period requirement for qualification as long-term capital gain with respect to certain partnership interests received in connection with the performance of investment-related services. The proposal applies to tax year 2018 and thereafter.
        - The loss of long-term capital gain treatment under this rule causes the gain to be classified as short-term capital gain. Such re-classification does not cause the gain to be subject to self-employment tax.
        - A special disposition rule applies to related-party dispositions of such interests in a manner analogous to the "hot asset rules."
        - The provision applies regardless of the application of section 83 (e.g., regardless whether a recipient of such interest included income upon receipt under section 83(a) or otherwise filed a section 83(b) election with respect to such interest).
    - The Conference Agreement follows the original Senate bill by providing that "excess business losses" of a taxpayer other than a C corporation 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. It attempts to match business losses to lower-taxed future business earnings.
        - An "excess business loss" 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 with respect to such trades or businesses plus a threshold amount. Such threshold is $500,000 for joint filers and $250,000 for other taxpayers. The threshold will be inflation adjusted.
        - In the case of a partnership or S corporation, the proposal applies at the partner or shareholder level.
        - The limitation is applied after the application of the passive activity loss limitations.
        - The limitation sunsets after December 31, 2025.
    - The Conference Agreement overrules *Grecian Magnesite Mining v. Commissioner* and codifies Revenue Ruling 91-32, following the original Senate bill with some clarifications.
        - Under the proposal, gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have 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 (excluding real property gain already classified as effectively connected under

the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)).

    - Any such gain or loss from the hypothetical asset sale would be allocated to interests in the partnership in the same manner as non-separately stated income and loss.
    - 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 or foreign corporation; similar to the current FIRPTA withholding/reporting regime. If the transferee fails to withhold, the relevant partnership must withhold the deficient amount from the transferee partner.
    - The general provision applies to dispositions occurring on or after November 27, 2017; however, the withholding requirements apply to dispositions occurring on or after January 1, 2018.
- The Conference Agreement expands the definition of a "substantial built-in loss" for purposes of section 743(d), following the original Senate bill. If a partnership has a substantial built-in loss, the partnership must adjust the tax basis of partnership property following a transfer of a partnership interest to approximate the result of a direct purchase of the property.
    - Under current law, 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 bill 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 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 proposal applies to transfers occurring in tax year 2018 and thereafter.
- The Conference Agreement expands the section 704(d) outside basis limitation on partner losses to provide that generally a partner's distributive share of charitable contributions (based on tax basis of contributed property) and foreign tax expenditures are allowed only to the extent of the partner's outside basis. This proposal follows the original Senate bill.
    - The proposal applies to tax year 2018 and thereafter.
- The Conference Agreement repeals the partnership technical termination rule, following the original House bill.
    - Thus, a partnership will be treated as continuing even if more than 50% of the total capital and profits interests of the partnership are sold or exchanged within a year, which will prevent partnerships from being required, or being permitted, to make new elections for various accounting methods, depreciation lives, and other purposes.
    - The proposal applies to tax year 2018 and thereafter.

- The Conference Agreement includes provisions to address tax issues that may arise upon a conversion of an S corporation to a C corporation within two years of the enactment of this legislation, following the original House bill.
  - In the case of a distribution of money by an eligible terminated S corporation after the post-termination transition period, the accumulated adjustments account (AAA) is allocated to such distribution, and the distribution is chargeable to accumulated earnings and profits, in the same ratio as the amount of such AAA bears to the amount of such accumulated earnings and profits. The rule essentially expands pre-existing tax relief offered to shareholders of a corporation that terminates its S election for generally one year after such termination so that it now applies to all periods thereafter as well, to the extent of any remaining undistributed AAA.
  - An "eligible terminated S corporation" means any C corporation which (1) was an S corporation on the day before the date of the enactment of the tax reform legislation and made a revocation of its S corporation election in the two-year period following such date, and (2) the owners of the stock of such corporation on the date of the revocation of the S corporation election are the same owners (and in identical proportions) as on the date of the enactment of the tax reform legislation.
  - The proposal also provides that, in the case of an eligible terminated S corporation, any taxable income adjustment arising from such a conversion under section 481 would be taken into account ratably over six years (e.g., from having to switch from the cash method to the accrual method of accounting).
  - The proposal applies to tax year 2018 and thereafter.
- The Conference Agreement permits a nonresident alien to be a potential current beneficiary of an electing small business trust (ESBT), following the original Senate bill.
  - An ESBT may be a shareholder of an S corporation. However, pre-existing law provides that eligible beneficiaries of an ESBT include only individuals, estates, and certain charitable organizations that are eligible to hold S corporation stock directly (e.g., only domestic individuals).
  - The proposal applies to tax year 2018 and thereafter.
- The Conference Agreement provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals, following the original Senate bill.
  - Thus, the percentage limitations and carryforward provisions applicable to individuals will apply to charitable contributions made by the portion of an ESBT holding S corporation stock.
  - The proposal applies to tax year 2018 and thereafter.

- **International Provisions**
  - **Dividend-Exemption System—Territorial Rules.**
    - The Conference Agreement generally follows the provision in the Senate bill, with some changes. The provision generally allows an exemption for certain foreign

income earned through a foreign corporation in which a domestic corporation owns at least 10% (enough to be regarded as a U.S. shareholder of the foreign corporation within the meaning of section 951(b)). The domestic corporation is permitted a 100% deduction for the foreign-source portion of dividends received (referred to as "DRD") from such a foreign corporation. No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to any portion of a distribution treated as a dividend that qualifies for the DRD. There are also provisions addressing hybrid dividends and holding periods.

  - The provision applies to distributions made (and for purposes of determining a taxpayer's foreign tax credit limitation under section 904, deductions in taxable years beginning) after December 31, 2017.

- **Tax on Deferred Foreign Income Upon Transition to Dividend-Exemption System.**
  - The Conference Agreement generally follows the Senate bill, with several modifications. The provision generally requires that, for the last taxable year beginning before January 1, 2018, any U.S. shareholder of a foreign corporation must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the corporation, determined as of November 2, 2017, or as of December 31, 2017, whichever is higher. The tax on the aggregate earnings and profits attributable to cash assets is 15.5%, while the tax on aggregate earnings and profits attributable to other assets is 8%. These tax rates have been increased from those in the House bill and in the Senate bill.
  - The provision is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to U.S. shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end.

- **Modifications Related to Foreign Tax Credit System.**
  - The Conference Agreement repeals the deemed-paid credit with respect to dividends received by a domestic corporation that owns 10% or more of the voting stock of a foreign corporation. This provision applies to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.
  - The Conference Agreement provides that 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. This provision is effective for taxable years beginning after December 31, 2017.
  - The Conference Agreement requires foreign branch income to be allocated to a specific foreign tax credit basket. Foreign branch income is the business profits of a U.S. person that are attributable to one or more qualified business units

(QBUs) in one or more foreign countries. Under this provision, 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 provision is effective for taxable years beginning after December 31, 2017.

- **Modification of Subpart F Provisions.**
  - The Conference Agreement repeals section 955. As a result, a U.S. shareholder in a controlled foreign corporation (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.
  - The Conference Agreement eliminates foreign base company oil related income as a category of foreign base company income.
  - The Conference Agreement 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 U.S. person for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC.
  - The Conference Agreement expands the definition of U.S. shareholder under subpart F to include any U.S. person who owns 10% or more of the total combined voting power or the total value of shares of all classes of stock of a foreign corporation. (Current law requires ownership of 10% or more of the total combined voting power.)
  - While both the House and the Senate bills would have repealed section 956 dealing with investments in U.S. property, the Conference Agreement does not repeal section 956.
  - The Conference Agreement eliminates the requirement that a corporation must be controlled for an uninterrupted period of 30 days before subpart F inclusions apply.
- **Current Year Inclusion of Global Intangible Low-Taxed Income (GILTI) by U.S. Shareholders.**
  - The Conference Agreement follows the Senate bill provision, with clarifications and modifications. Under the Conference Agreement, a U.S. shareholder of any CFC must include in gross income for a taxable year its GILTI in a manner generally similar to inclusions of subpart F income.
    - GILTI means, with respect to any U.S. 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.
    - Net deemed tangible income return is, with respect to any U.S. shareholder for a taxable year, the excess (if any) of 10% of the aggregate of its pro rata share of the qualified business asset investment (QBAI) of each CFC with respect to which it is a U.S. shareholder over the amount of interest expense taken into account in determining its net

CFC tested income for the taxable year to the extent that the interest expense exceeds the interest income properly allocable to the interest expense that is taken into account in determining its net CFC tested income. The Conference Agreement modified the formula along the lines of the original House bill to exclude interest expense in an effort to prevent taxpayers from increasing QBAI through leverage.

- The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

- **Deduction for Foreign-Derived Intangible Income and GILTI.**
  - The Conference Agreement follows the Senate bill, with clarifications and modifications. In the case of domestic corporations, for taxable years beginning after December 31, 2017, and before January 1, 2026, the provision generally permits a taxpayer a deduction in an amount equal to the sum of 37.5% of its foreign-derived intangible income (FDII) plus 50% of its GILTI (if any) that is included in the income of the taxpayer. For taxable years beginning after December 31, 2025, the deduction for FDII is reduced to 21.875% and the deduction for GILTI is lowered to 37.5%.
  - Under the 21% corporate tax rate under the Conference Agreement,, as a result of the deduction for FDII and GILTI, the effective tax rate on FDII is 13.125% and the effective U.S. tax rate on GILTI for domestic corporations is 10.5% for taxable years beginning after December 31, 2017, and before January 1, 2026. Because only 80% of foreign tax credits are allowed to offset U.S. tax on GILTI, the minimum foreign tax rate to eliminate residual tax on GILTI is 13.125%

- **Base Erosion Minimum Tax.**
  - The provision in the Conference Agreement for the base erosion minimum tax (or the base erosion anti-abuse tax (BEAT)) follows the Senate bill with some changes.
  - Under the provision, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. The base erosion minimum tax amount is the excess of 10% of the modified taxable income of the taxpayer for the taxable year over an amount equal to the regular tax liability (defined in section 26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess (if any) of the credits allowed under Chapter 1 against such regular tax liability over the sum of: (1) the credit allowed under section 38 for the taxable year, which is properly allocable to the research credit determined under section 41(a), plus (2) the portion of the applicable section 38 credits not in excess of 80% of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)).
    - Applicable section 38 credits means the low income housing credit determined under section 42(a), the renewable electricity production credit determined under section 45(a), and the investment credit determined under section 46, but only to the extent allocable to the energy credit determined under section 48. These credits were added in

the Conference Agreement.

        - These rules are modified for taxable years beginning after December 31, 2025, at which time the 10% rate in the computation above becomes 12.5% and the special treatment of the specific credits listed above is eliminated.

    - Applicable taxpayer means with respect to any taxable year, a taxpayer: (1) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (2) the average annual gross receipts of the corporation for the three-taxable-year period ending with the preceding taxable year are at least $500 million, and (3) the base erosion percentage of the corporation for the taxable year is 3% or higher (reduced from 4% in the Senate bill).
    - The provision 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 provision applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

- **Other Anti-Base Erosion Measures.**
    - **Limitations on income shifting through intangible property transfers.**
        - The Conference Agreement follows the Senate bill. The provision 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 provision revises that definition to include workforce in place, goodwill, and going concern value. The provision 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 provision 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 Conference Agreement follows the Senate bill with certain modifications.
        - The provision 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 U.S. shareholder under section 951(a). A related party for these purposes is generally determined under the rules of section 954(d)(3).

- The Conference Agreement also provides that the Secretary shall issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of the provision for branches (domestic or foreign) and domestic entities, even if such branches or entities do not meet the statutory definition of a hybrid entity.
- The provision is effective for taxable years beginning after December 31, 2017.

- **Surrogate foreign corporations not eligible for reduced rate on dividends.**
  - The Conference Agreement follows the Senate bill with a modification.
  - Under the provision, 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 Conference Agreement modifies the Senate bill to provide that the provision applies to dividends received from foreign corporations that first become surrogate foreign corporations after date of enactment.
  - The provision is effective for dividends received after date of enactment.
- The Conference Agreement does not include either the House or Senate version of a provision that would have limited the deduction of interest by domestic corporations which are members of an international group.

- **Other International Reforms.**
  - The Conference Agreement prohibits members of a U.S. 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 provision is effective for taxable years beginning after December 31, 2017.

- **Business Deductions**
  - **Interest.** Under the Conference Agreement, the amount of net interest that can be deducted by any business with gross receipts of $25 million or more (measured based on average over a three-year period) is generally limited to 30% of the adjusted taxable income for the year.
    - The Conference Agreement adopts the higher gross receipts threshold of $25 million of the House bill.
    - 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 20% deduction for certain pass-through income; and (4) the amount of any net operating loss deduction. For taxable years beginning before January 1, 2022, adjusted taxable income is further computed without regard to deductions allowable for depreciation, amortization, or depletion.

    - The interest 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.

- **Net Operating Losses (NOL).** The Conference Agreement limits the NOL deduction to 80% of taxable income, effective for taxable years beginning after December 31, 2017. The Conference Agreement also repeals the two-year carryback and the special carryback provisions, but provides an exception for certain farming losses. The Conference Agreement generally follows the Senate bill, but with an earlier effective date for the 80% limitation (the Senate bill limited the NOL deduction to 90%, decreasing to 80% after 2022).
- **Depreciation and Expensing.** The Conference Agreement increases the 50% bonus depreciation under current law to 100% through 2022 (through 2023 for longer production period property and certain aircraft). The Conference Agreement also extends the current 50% bonus depreciation through 2026 (2027 for longer production period property and certain aircraft).
    - The Conference Agreement follows the House bill and removes the requirement that the original use of qualified property must commence with the taxpayer. As a result, the Conference Agreement allows the additional first-year depreciation deduction for new and used property.
    - The provision generally applies to property acquired and placed in service after September 27, 2017, and to specified plants planted or grafted after such date. A transition rule provides that, for a taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect to apply a 50% allowance instead of the 100% allowance.
- **Recovery Period for Real Property.** The Conference Agreement does not include the changes in the Senate bill to the recovery periods for nonresidential real and residential real property. The Conference Agreement maintains the present law general modified accelerated cost recovery system (MACRS) recovery periods of 39 and 27.5 years for nonresidential real and residential rental property, respectively. The Conference Agreement eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and provides a general 15-year MACRS recovery period for qualified improvement property.

- **Research and Experimental Expenditures.** The Conference Agreement requires research and experimental expenditures to be capitalized and amortized ratably over a five-year period (15 years for specified foreign expenditures), beginning with the midpoint of the taxable year in which the specified expenditures were paid or incurred. Amounts paid or incurred in connection with the development of software are treated as a research and experimental expenditures. The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2021. This provision is similar to the provisions in the House and Senate bills, but the effective date in the Conference Agreement is earlier than in either the House bill (years after December 31, 2022) or the Senate bill (years after December 31, 2025).
- **Like-Kind Exchanges.** The Conference Agreement limits like-kind exchanges under section 1031 to exchanges of real property. The Conference Agreement 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. The Conference Agreement follows the provision in both the House and Senate bills.
- **Domestic Production Deduction.** The Conference Agreement follows the House bill and repeals the domestic production deduction for taxable years beginning after December 31, 2017 (instead of after 2018 as provided in the Senate bill).

INSURANCE COMPANIES AND BANKS

- **Life Insurance Companies**
  - The Conference Agreement amends section 805 and repeals sections 810 and 844 to make the net operating loss carry over and back provisions of section 172 applicable to life insurance companies, following both the House and Senate bills.
  - The Conference Agreement repeals the section 806 small life insurance company deduction, following both the House and Senate bills.
  - The Conference Agreement 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, following both the House and Senate bills.
  - The Conference Agreement repeals section 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 is brought into income ratably over 8 years starting in 2018. This provision follows both the House and Senate bills.
  - The Conference Agreement provides numerous amendments to the section 807 reserve computation rules. This provision follows the Senate bill, except that, instead of 92.87% , the percentage relating to the statutory reserve is 92.81%.
    - Section 807(c) is amended to provide that for purposes of section 807(c)(3) the appropriate rate of interest is the highest rate or rates permitted by the National Association of Insurance Commissioners (NAIC).
    - Section 807(d) is amended to provide that life insurance reserves (other than for certain variable contracts) are the greater of (1) the contract's net surrender

value or (2) 92.81% of the amount determined using the otherwise applicable tax reserve method. For variable contracts, life insurance reserves are the sum of (1) the greater of (a) the contract's net surrender value or (b) the section 817 separate-account reserve amount, plus 92.81% of the excess (if any) of the amount determined using the otherwise applicable tax reserve method over the amount determined in (1). The amount so determined is subject to a statutory reserve cap and to a no-double-counting rule.

        - Special rules are provided for qualified supplemental benefits. In addition, reporting rules require reporting of opening and closing reserve balances and with respect to the reserve methods used.
        - In addition, the section 7702 definition of life insurance reserves is amended with respect to reasonable mortality charges and prevailing Commissioners' standard tables.
        - Finally, any resulting section 481 adjustment is taken into account over an 8-year spread period.
    - The Conference Agreement amends section 812 to specify that proration purposes the company's share is 70% and the policyholders' share is 30%, following the Senate bill.
    - The Conference Agreement amends the section 848 policy acquisition expense rules by extending the amortization period for specified acquisition expenses from 120 months to 180 months. In addition, the percentages applicable to the three categories of specified insurance contracts are changed: for annuity contracts the percentage is changed from 1.75% to 2.09%, for group contracts the percentage is changed from 2.05% to 2.45%, and for other contracts the percentage is changed from 7.7% to 9.2%. The Conference Agreement follows the Senate bill with some modifications.
    - The House bill would have imposed an additional 8% income tax on life insurance company taxable income. This is not adopted by the Conference Agreement.
- **Propery/Casualty Insurance Companies**
    - The Conference Agreement follows the Senate bill and amends section 832 to provide that, for proration purposes, the percentage used in calculating the reduction in the losses incurred deduction attributable to tax-exempt interest and the dividends received deduction is increased from 15% to 5.25% divided by the top corporate tax rate. For 2018 the percentage will be 15%. Thereafter, the percentage will be 25%, unless the top corporate tax rate of 21% is changed.
    - The Conference Agreement follows both the House and Senate bills and repeals section 847 and the special estimated tax payment rules related to the difference between discounted and undiscounted reserves.
    - The Conference Agreement 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 a 60-month corporate bond yield curve specified by Treasury. Second, the computational rules for the 10-year loss payment pattern is extended to a maximum of 14 more years. Third, the election to use a company's historic payment pattern is repealed. Any transition adjustment is taken into account ratably over eight years.

- **Tax Reporting of Life Settlement Transactions**
  - The Conference Agreement follows the Senate bill and imposes reporting requirements on life insurance contract issuers and on persons who acquire a life insurance contract in a reportable policy sale, which is an acquisition of the contract from an unrelated insured. The contract buyer must report specified information to the seller and the contract issuer. In addition, the contract issuer must report the seller's basis to the IRS and, upon the payment of the death benefit, the issuer must report to the IRS the contract's basis and the payment amount.
  - The Conference Agreement reverses Rev. Rul. 2009-13 and provides rules for determining the tax basis of life insurance contracts.
  - The Conference Agreement provides an exception to the transfer-for-value rules for reportable policy sales of life insurance policies.
- **Banks**
  - The Conference Agreement follows the Senate bill and denies a deduction for the applicable percentage of FDIC premiums paid or incurred by large financial institutions (assets over $10 billion). The applicable percentage is the ratio that the excess of total consolidated assets over $10 billion bears to $40 billion. An aggregation rule applies.
- **Insurance Exception to Passive Foreign Investment Company (PFIC) Rules**
  - The Conference Agreement amends section 1297 to replace the test based on "predominantly engaged in an insurance business" with a test tied to the corporation's insurance liabilities. To qualify, the corporation must be one that would be taxed as an insurance company if it were a domestic corporation and whose "applicable insurance liabilities" constitute more that 25% of its total assets. Applicable insurance liabilities are reserves (other than deficiency, contingency and unearned premium reserves) plus loss and loss adjustment expenses. An alternative facts and circumstances test, to be provided in regulations, may apply.

COMPENSATION AND RETIREMENT SAVINGS

- **Compensation**
  - **$1 Million Deduction Cap.**
    - The Conference Agreement modifies the $1 million deduction cap on public company executive compensation under section 162(m), and adds a transition rule under which such changes would not apply to remuneration subject to a written binding contract entered into before November 17, 2017 (and not thereafter modified), subject to certain conditions outlined in the Joint Explanatory Statement. The Conference Agreement includes commissions and performance-based compensation in the calculation of the $1 million cap, changes the executives to whom section 162(m) applies to the principal executive officer, the principal financial officer, and the three most highly compensated officers, expands the definition of "public company" for section 162(m) excise tax purposes, and changes certain timing rules. These changes were included in prior versions of the bill.

        - *See* Exempt Organizations, below, for a discussion of the excise tax on tax-exempt organizations for excessive compensation.
    - **Excise Tax on Tax Exempt Organizations for Excessive Compensation.**
        - The Conference Agreement imposes a new excise tax on tax-exempt organizations for paying certain remuneration to the top five most highly compensated employees. In a change from other versions of the bill, the Conference Agreement sets the excise tax at the 21% corporate tax under section 11, multiplied by compensation amounts in excess of $1 million, and compensation amounts that are contingent upon a separation from employment paid to applicable executives, calculated in a manner similar to the excess parachute tax under sections 280G and 4999. Prior versions of the bill set the section 162(m) excise tax at 20%. In another change from prior versions of the bill, the Conference Agreement provides that remuneration is treated as paid when there is no substantial risk of forfeiture (as defined under Section 457(f)) for such remuneration, including for this purpose, amounts required to be included in gross income under section 457(f).
    - **"Qualified Stock" Election.**
        - The Conference Agreement includes a new election pertaining to "qualified stock." The election is similar to a section 83(b) election, that would apply to stock related to stock options and stock-settled restricted stock units granted to certain employees of a non-public company under a broad-based equity compensation plan. The Conference Agreement would require the plan to cover at least 80% of employees in the controlled group. The provision is similar to the provision contained in prior versions of the bill, with certain modifications for Section 123 plans, the definitions of eligible and ineligible employees, and the determination of the 80% requirement.
    - **Excise Tax on Stock Compensation for Expatriated Corporation Executives.**
        - The Conference Agreement increases the 15% rate of excise tax, imposed on the value of stock compensation held by insiders of an expatriated corporation, to 20%, effective on the date the corporations first becoming expatriated corporations after the date of enactment.
- **Affordable Care Act**
    - The Conference Agreement would reduce to zero the individual mandate penalty on individuals who fail to maintain healthcare coverage under the Affordable Care Act, modifying in section 5000A, effective for years after December 31, 2018.
- **Retirement Savings**
    - The Conference Agreement would repeal a special rule that allows an individual to recharacterize a contribution to a traditional IRA as a contribution to a Roth IRA, and vice versa, with some exceptions. Under the provision, recharacterization cannot be used to unwind a Roth conversion, but it may be used with respect to other contributions. This provision was also included in the House bill and Senate Amendment, with a slight modification in the Conference Agreement.

- The Conference Agreement would extend the period of time during which a plan participant may rollover a plan loan in the event an employee separates from service, or the plan terminates, while a loan is outstanding. The time period would be extended from 60 days to the due date of the employee's tax return. This provision was also included in the Senate Amendment, and a slightly modified version was included in the House bill.
- The Conference Agreement would provide tax relief relating to areas in which a major disaster was declared by the president in 2016, including a special exception to the 10% early withdrawal tax for a qualified "2016 disaster area" distribution from a qualified retirement plan, 403(b) plan, or IRA. This provision was also included in the Senate Amendment, with a slight modification.
- The Conference Agreement would modify rules applicable to length of service award programs for bona fide public safety volunteers, including increasing the aggregate amount of length-of-service awards that may accrue for a bona fide volunteer with respect to any year of service. This provision was also included in the Senate Amendment.
- The Conference Agreement does not include certain retirement provisions from the House bill that would have reduced the minimum age for in-service distributions, modified the hardship distribution rules, modified the nondiscrimination rules, and applied the unrelated business income tax rules to governmental pension plans and other entities exempt from tax under section 501(a).

- **Employment-Related Fringe Benefits.**
  - **Deduction for Business-Related Entertainment Expenses.**
    - The Conference Agreement follows the Senate Amendment and repeals deductions allowed under current law for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, including the 50% limit to such deductions). Accordingly, under the Conference Agreement, no deduction is allowed for such entertainment, amusement, or recreation activities or facilities, including membership dues with respect to any club organized for business, pleasure, recreation, or other social purposes.
    - A deduction is still generally available, as under current law, for 50% of food and beverage expenses associated with operating a trade or business (e.g., meals consumed by employees on work travel). Under the Conference Agreement the 50% limit applies from December 31, 2017, through December 31, 2025, to expenses for food and beverages provided to employees through an eating facility operating for the convenience of the employer, and are non-deductible after December 31, 2025.
    - The Conference Agreement disallows the current law deduction for expenses relating to entertainment tickets and to skyboxes to the extent that the expenses are included as compensation to an employee on the employer's tax return, effective December 31, 2017.
  - **Deduction for Transportation Fringes.**
    - The Conference Agreement adopts the Senate Amendment and eliminates the current deduction for qualified transportation fringes to employees, except as

necessary for the safety of an employee in commuting between work and home, effective December 31, 2017. The deduction for bicycle commuting reimbursements is suspended between December 31, 2017, and December 31, 2026.

- **Deduction for Employee Achievement Awards.**
  - The Conference Agreement adopts the Senate Amendment and changes the current law deduction under section 274(j)(3), by disallowing an employer deduction, up to certain limits, for the cost of an employee achievement award for length of service or safety achievement, subject to certain conditions. Effective December 31, 2017, the Conference Agreement eliminates the deduction for employee achievement awards paid in the form of cash, cash equivalents, gift cards, gift coupons, or gift certificates (with some limitations), paid vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and similar items.
- **Deduction and Income Exclusion for Moving Expenses.**
  - The Conference Agreement suspends both the current law exclusion from income under section 132(g) and the employer's deduction under section 217 for employer reimbursement of qualified moving expenses for a job-related move for the period between December 31, 2017, and January 1, 2026, except in the case of a member of the U.S. Armed Forces active duty who moves pursuant to a military order and incident to a permanent change of station. Similar provisions were included in prior versions of the bill.

INDIVIDUALS

- **Individual Rates and Standard Deduction**
  - Individual income tax brackets are set at 10, 12, 22, 24, 32, 35, and 37%. The rate structure does not apply to taxable years beginning after December 31, 2025.
  - The standard deduction is increased to $12,000 for individuals and $24,000 for married couples. The amount of the standard deduction is indexed for inflation using the Chained Consumer Price Index for All Urban Consumer (C-CPI-U) for taxable years beginning after December 31, 2018. The increase of the basic standard deduction does not apply to taxable years beginning after December 31, 2025.
- **State and Local Tax Deduction**
  - The Conference Agreement modifies the House and Senate bills to generally eliminate the deduction for state and local taxes, except for a limited deduction for state and local property, income, or sales taxes up to $10,000.
- **Mortgage Interest Deduction**
  - The Conference Agreement would limit the individual deduction of home mortgage interest. For acquisition indebtedness incurred after December 15, 2017, the current limit of $1 million for deductible interest is reduced to $750,000. The reduction in the limit ends for taxable years beginning after December 31, 2025.

- The Conference Agreement would not allow interest on home equity debt incurred after December 31, 2017. The suspension ends for taxable years beginning after December 31, 2025.

- **Child Tax Credit**
  - The child tax credit is increased from $1,000 to $2,000 per child under age 17. The bill also provides for a $500 nonrefundable credit for qualifying dependents other than qualifying children. The maximum amount refundable may not exceed $1,400 per qualifying child.
  - The Conference Agreement also provides that, in order to receive the child tax credit (*i.e*., both the refundable and non-refundable portion), a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed.
  - This provision expires for taxable years beginning after December 31, 2025.

- **Estate, Gift, and Generation-Skipping Transfer (GST) Tax**
  - The Conference Agreement adopts the Senate proposals with respect to estate, gift, and GST taxes without modification.
  - The estate, gift, and GST tax exemption would be doubled 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 and before January 1, 2026. Exemptions would revert back to $5 million (indexed for inflation) after December 31, 2025.
  - There is no provision for ultimate repeal of the estate, gift, or GST taxes.
  - Estate, gift, and GSTs would still be subject to a maximum tax rate of 40% (no change in rates).
  - The current law basis step up under section 1014 for property received from a decedent at death would be retained.

EXEMPT ORGANIZATIONS

- **Political Activity by Charities (Johnson Amendment)**
  - The Conference Agreement does not include a provision from the House bill that would have partially repealed the longstanding prohibition on charities intervening in political campaigns (also known as the Johnson amendment).

- **Charitable Contribution Incentive**
  - As with the House and Senate bill, the Conference Agreement leaves the charitable contribution deduction in place as an itemized deduction. No “universal” or “above-the-line” deduction is adopted.
  - The Conference Agreement makes a number of modifications to the charitable contribution incentive. As with the House and Senate bills, the Conference Agreement: (1) temporarily increases the individual percentage-of-income limitation for cash gifts from 50% to 60% (through 2025); (2) denies a deduction for contributions linked to rights to purchase tickets to college athletic events; and (3) repeals the controversial option in

section 170(f)(8)(D) whereby the IRS may allow donee organizations to report charitable contributions to the IRS instead of sending a contemporaneous written acknowledgement to donor. An additional change to the amount deductible for use of a passenger automobile for charitable purposes that was only included in the House bill was not adopted.

- As with the House and Senate bills, the Conference Agreement generally reduces the number of taxpayers taking itemized deductions, thus effectively limiting the benefit of the current charitable contribution deduction, and weakens the tax incentive to make charitable contributions at death from 2018 through 2025 by (1) increasing the standard deduction while repealing or limiting many itemized deductions; (2) reducing marginal tax rates; and (3) doubling the credit against estate, gift, and generation skipping transfer tax.

- **Unrelated Business Income Tax (UBIT)**
  - The Conference Agreement includes a provision from the House bill that expands UBIT to tax certain fringe benefits (qualified transportation, qualified parking, and on-premises athletic facilities) provided to employees of tax-exempt employers.
  - The conference agreement also includes a provision from the Senate bill that requires UBIT be computed separately with respect to each separate business, so deductions from one business generally cannot offset income from another.
  - Two UBIT-related provisions from the House bill were not adopted. They would have: (1) clarified that UBIT applies to "dual-status" organizations, which are exempt under both section 501 and another Code section; and (2) narrowed the UBIT exclusion for fundamental research organizations, limiting exclusion to income from research that is freely available to the public.
- **Investing and Finance**
  - The Conference Agreement imposes a 1.4% excise tax on the net investment income of private colleges and universities with more than 500 students (provided more than half are in the United States) and assets in excess of $500,000 per student. Assets and income of certain related organizations would be aggregated. A similar proposal was included in both the House and Senate bills.
  - As with both the House and Senate bills, the Conference Agreement repeals the current income tax exclusion for interest on advance refunding bonds, effective for bonds issued after December 31, 2017. The Conference Agreement does not include a proposal from the House bill that would have repealed the current income tax exclusion for interest on private activity bonds, including qualified 501(c)(3) bonds frequently used by charities to fund capital improvements.
  - The Conference Agreement adopts a Senate bill provision, with some modifications, that permits designation of certain low-income community population census tracts as qualified opportunity zones, and provides tax incentives to encourage investment in these opportunity zones. The Conference Agreement does not repeal the New Markets Tax Credit, as the House bill would have.
  - The Conference Agreement does not replace the current two-tier private foundation excise tax on investment income with a flat 1.4% tax. This proposal had been included in the House bill.

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- **Employee Salaries/Benefits**
  - Similar to the House and Senate bills, with some modifications, the Conference Agreement imposes a 21% excise tax (up from 20% in the House and Senate bills) on compensation over $1 million paid by tax-exempt employers to the five highest compensated employees and certain other employees, apparently intended to mirror the section 162(m) limit on deductibility, which applies only to publicly traded companies. Like the House and Senate bills, it also imposes the excise tax on payments to certain employees that are contingent upon a separation from employment, calculated in a manner similar to the excess parachute tax under section 280G. The Conference Agreement includes an exemption for certain compensation paid to some medical professionals, an exemption for parachute payments paid to employees who are not highly compensated, and clarification regarding the timing of tax on compensation subject to a substantial risk of forfeiture. No transition rule similar to that provided in 162(m), which provides relief for payments made under certain pre-existing contracts, was provided for tax-exempt employers.
  - As noted above, the Conference Agreement includes a provision from the House bill that expands UBIT to tax certain fringe benefits (qualified transportation, qualified parking, and on-premises athletic facilities) provided to employees of tax-exempt employers.
  - The Conference Agreement does not repeal, sunset, or limit exclusions from employee income for dependent care assistance programs, adoption assistance programs, or employer-provided housing, as the House bill proposed.
- **Education Incentives**
  - As with the Senate bill, the Conference Agreement: (1) allows section 529 accounts to be used for up to $10,000 of elementary and secondary school tuition and certain home school expenses, until the end of 2025; (2) excludes from income student loan discharges for death or disability, until the end of 2025; and (3) allows rollovers from section 529 plans into ABLE accounts, and increases contribution limit for ABLE accounts, until the end of 2025.
  - The Conference Agreement does not include provisions from the House bill that would have consolidated the American Opportunity, Hope Scholarship, and Lifetime Learning credits into a single American Opportunity Tax Credit and eliminated a number of other education-related deductions and exclusions.
  - The House bill would have repealed the above-the-line deduction for teacher expenses, while the Senate bill would have doubled the deduction. The Conference Agreement leaves the current deduction unchanged.
- **Other Provisions From House Bill Not Included**
  - The Conference Agreement does not include a House bill provision that would have provided a limited exception to the private foundation excess business holding rules for certain wholly-owned and independently operated businesses where all net operating income promptly is distributed for use in the foundation’s charitable purposes.
  - The Conference Agreement does not include a House bill provision that would have denied private operating foundation status to certain organizations that operate art museums unless the museum is open to the public at least 1,000 hours per year.

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- The Conference Agreement does not include a House bill provision that would have subjected donor advised fund sponsoring organizations to additional reporting requirements.