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U.S. Senate Passes Its Version of the Tax Cuts and Jobs Act (H.R. 1); Descriptions of the Bills Passed in the House and Senate and Outstanding Differences to be Resolved in Conference

Tax Talks Blog on **December 8, 2017**

In the early hours of Saturday morning, the U.S. Senate passed the Tax Cuts and Jobs Act (H.R. 1) (the "Senate bill"), just over two weeks after the U.S. House of Representatives passed its own version of the same legislation (the "House bill"). Members of the House and Senate will next convene in conference to attempt to reconcile the House and Senate versions of the legislation. Identical versions of the bill must be passed by simple majorities in both the House and the Senate before the bill, and signed by President Trump, before such legislation will become law.

The final Senate bill, although similar to the bill passed by the Senate Finance Committee on November 16, contains several important changes. We outline some of the most significant changes below, followed by a list of some of the major outstanding points of difference between the House and Senate bills as passed by the respective chambers. We then discuss in detail some of the most significant provisions of both bills.

The provisions discussed are generally proposed to apply to tax years beginning after December 31, 2017, subject to certain exceptions (only some of which are noted below). While we discuss some of these provisions in detail, we do not address all restrictions, exclusions, and various other nuances applicable to any given provision.

Summary of significant changes in the Senate bill

- **Businesses**
  - The proposed pass-through deduction is increased to 23% from 17.4%, for a maximum effective rate of 29.645% ([100% – 23%] * 38.5% = 29.645%)

compared with 31.8% under the original Senate bill.

- The corporate alternative minimum tax ("AMT") is preserved. (An earlier version of the Senate bill would have eliminated the corporate AMT entirely.)
- Proposed full expensing of new property placed into service would be partially extended and eventually phased out beginning in 2023.
- Deductions for income attributable to domestic production activities of non-corporate taxpayers would be eliminated.
- The current law treatment of "interest charge domestic international service corporations" (IC-DISCs) is preserved.
- Proposed changes to the computation of life insurance reserves are eliminated.
- A revenue "trigger" that would have prevented a number of scheduled revenue-raising provisions from taking effect was eliminated.

Foreign income

- The tax rates for the one-time deemed repatriation of foreign earnings are increased to 7.5% on non-cash assets (up from 5%) and 14.5% on cash assets (up from 10%). The new proposed rates are very close to those proposed in the House bill (14% and 7%, respectively).
- A new phase-in for the proposed limitation on excess indebtedness of U.S. groups would raise the initial threshold for "excess domestic indebtedness" to 130%, and gradually reduce this to 110% by tax years beginning after December 31, 2021.
- Banks and securities dealers subject to the proposed base erosion and anti-abuse tax (or "BEAT") would be taxed at an 11% rate (increasing to 13.5% in later tax years)) rather than the general 10% rate (increasing to 12.5%) imposed on C corporations with substantial gross receipts and significant deductible foreign payments.

Individuals

- Rather than fully repeal of the individual AMT, the final Senate bill would increase exemption amounts and phase-out thresholds.
- Like the House bill, the final Senate bill preserves the itemized deduction for state and local property taxes, but caps it at $10,000.
- The current law 10% adjusted gross income ("AGI") floor for medical expense deductions would be lowered temporarily from 10% to 7.5% for tax years beginning after December 31, 2016, and ending before January 1, 2019.

- **Tax-exempt organizations.**
  - The final Senate bill eliminates a provision that would have imposed a 10% entity-level tax on excess benefit transactions and would have repealed the current law rebuttable presumption of reasonableness for transactions with disqualified persons.
  - The final Senate bill eliminates a provision that would have caused royalty and license income from name rights and logos to be “unrelated business taxable income” to tax-exempt organizations.
  - The current-law tax exemption for certain sports leagues under section 501(c)(6) is preserved.

Summary of key differences between the bills passed by the House and by the Senate

- **Businesses**
  - The House bill would cut the corporate rate to 20% for tax years beginning in 2018; the Senate bill delays this reduction by one year to 2019.
  - The Senate bill reduces the tax rate on pass-through business income with an individual above-the-line deduction of 23% (for a maximum effective rate of 29.645%), whereas the House bill provides for a maximum 25% rate for this type of income (or 9% for certain taxpayers below an income threshold). The Senate and House bills also differ in their determination of income eligible for the reduced rate, and the requirements for specified service businesses to qualify for the reduced rate. Only the Senate bill has an absolute cap on the amount eligible for deduction equal to 50% of the taxpayer’s share of W-2 wages paid by the pass-through. Under the Senate bill, taxpayers with taxable income below $500,000 for married couples and $250,000 for single individuals would be entitled to the deduction without regard to the W-2 wage limitation and even if the pass through is engaged in a specified service business. The Senate bill’s 23% deduction would sunset in tax years beginning after December 31, 2025.
  - Only the House bill would repeal the corporate AMT.
  - The interest expense limitation in the Senate bill would be based on a percentage of a taxpayer’s earnings before interest and taxes (“EBIT”) and would likely be significantly more restrictive than the House bill, which would also add back depreciation and amortization expenses to earnings

("EBITDA").

- Under both bills, the deduction for net operating losses would initially be limited to 90% of net income, but would be further reduced to 80% for tax years beginning after December 31, 2022 under the Senate bill only.
- The Senate bill would treat gain or loss on the sale of a partnership interest as effectively connected income to a U.S. trade or business to the extent gain on the sale of the underlying partnership assets would be treated as ECI to a foreign corporation or nonresident alien individual. The House bill does not contain a similar provision.

- **Foreign income**
  - The House bill would impose a 10% tax on the foreign high returns of U.S. corporations' foreign subsidiaries; the Senate bill would impose a 10% "global intangible low-taxed income" ("GILTI") tax (increased to 12.5% for tax years beginning after December 31, 2025) based on a similar formula.
  - The Senate bill would introduce a 12.5% partial patent box regime for the deemed foreign intangible income of U.S. corporations (increased to 15.625% for tax years beginning after December 31, 2025).
  - The Senate bill would impose a 10% base erosion minimum tax on very large corporations (increased to 12.5% for tax years beginning after December 31, 2025) with significant deductible payments to related foreign parties, whereas the House bill would impose a 20% excise tax on deductible payments to related foreign parties.
  - Both bills would allow a 100% dividends-received deduction for the foreign-source portion of a dividend paid by a foreign corporate to a 10% U.S. corporate shareholder; however, only the Senate bill excludes hybrid dividends, dividends from PFICs, and dividends from "inverted" corporations.

- **Individuals**
  - Under the Senate bill only, apart from the ACA individual mandate repeal and use of chained CPI-U to index for inflation, all changes to individual taxation would sunset for tax years after December 31, 2025.
  - The House bill proposes 4 tax brackets at rates ranging from 12% to 39.6%; the Senate bill proposes 7 brackets at rates ranging from 10% to 38.5%.
  - Only the Senate bill repeals the Affordable Care Act's individual mandate.
  - The House bill repeals the individual AMT entirely, while the final Senate bill retains the individual AMT but increases the exemption and phase-out

thresholds.

- The Senate bill would retain the current law cap on mortgage indebtedness eligible for an interest exemption at $1,000,000 while the House bill would reduce the cap to $500,000.
- The Senate bill would increase the child tax credit to $2,000 (from $1,000 under current law), compared to only $1,600 under the House bill. The benefit begins phasing out under the House bill at incomes over $230,000 for joint filers, compared to $500,000 under the Senate bill.
- Under the Senate bill, the AGI threshold after which medical expenses can be deducted would be retained and lowered temporarily to 7.5% from 10%. The House bill would eliminate this deduction entirely.
- Only the House bill would repeal the estate tax entirely for tax years beginning after December 31, 2023. Both bills immediately double the current exemption from $5.6 million to $11.2 million (2018 rates, adjusted for inflation).

- **Tax-exempt organizations**
  - The House would repeal the exemption for interest on private activity bonds, advanced refunding bonds, and stadium-financing bonds. The Senate bill provides only for repeal of the exemption for advanced refunding bonds.
  - The House bill would allow section 501(c)(3) charities to engage in certain forms of political speech (a limitation on the so-called “Johnson Amendment”); the Senate bill does not contain a similar provision.

Detailed discussion of the Senate bill provisions

I. Business Provisions.

UPDATE 12/02/17: 20% tax rate on corporate income beginning in 2019; corporate AMT preserved.

The Senate bill proposes a permanent reduction of the corporate tax rate from 35% to 20%. Unlike the House bill, which also would reduce the corporate tax rate from 35% to 20%, the Senate bill would delay the rate reduction one year for tax years beginning after December 31, 2019. A current 35% and delayed 20% rate presents planning opportunities for U.S. corporations. For example, a U.S. corporation could purchase an asset, and sell it in 2018 if it had decreased in value (and claim a deduction at the 35% rate) or hold it until 2019 if it increases in value (and benefit from the new lower rate).

Although the House bill (and an earlier version of the Senate bill) would repeal the corporate alternative minimum tax ("AMT") entirely, the final Senate bill preserves the corporate AMT. The Senate bill's preservation of the AMT (at least at its current 20% rate) would deny corporations credits and incentives that are adjustments and preferences under the AMT, such as the research and development tax credit..

Correlative reduction of corporate dividends received deduction ("DRD").

Under each bill, the amount of dividends received that a corporation could deduct from its taxable income would be reduced to 50%, in the case of 70% deductible dividends under current law, or 65%, in the case of 80% deductible dividends. The effect would be to reduce the rate of tax for a corporate shareholder entitled to a 70% DRD under current law from 10.5%[1] to 10%[2] and maintain it at 7% for a corporate shareholder entitled to the 80% DRD under current law. A corporation would continue to deduct 100% of the dividends received from another corporation within the same affiliated group.

UPDATE 12/02/17: Net business interest deductions limited to 30% of earnings before interest and taxes.

Under proposed new section 163(j), net business interest deductions would generally be limited to 30% of a taxpayer's adjusted taxable income. Adjusted taxable income under the Senate bill is calculated using a method similar to earnings before interest and taxes ("EBIT"). In contrast, the House bill uses a formula closer to earnings before interest, taxes, depreciation, and amortization ("EBITDA"), which would in many cases lead to a larger base amount of earnings and therefore increase the size of the cap. "Business interest" would include any interest paid or accrued on indebtedness "properly allocable to a trade or business" but would not include "investment interest" (as described in section 163(d)). Excluded interest deductions could be carried forward indefinitely under the Senate bill, compared to only five years in the House bill.

For a partnership, the limitation would be applied at the partnership level, applying additional rules to prevent any double counting of the deduction and to allow for an increased deduction limit for excess taxable income applying rules similar to those in current section 163(j). For a group of affiliate corporations filing a consolidated return, the limitation similarly applies at the consolidated return level.

The limitation would not apply to taxpayers with gross receipts of $15 million or less ($25 million under the House bill) or to certain regulated public utilities. Additionally, real property development, construction, rental property management, or similar companies could elect not to be treated as a trade or business and, as a result, would not be subject to this limitation. Under the final Senate bill, floor plan financing interest, i.e., interest paid or accrued on indebtedness used to finance the purchase of motor vehicle inventories (including boats and farm equipment) would not be subject to this limitation.

Proposed 90% limitation on net operating loss deductions, reduced to 80% in 2023.

Under both the Senate bill and the House bill, deductions for net operating losses ("NOLs") would be limited to 90% of taxable income for any tax year. Under both bills, NOLs would no longer expire after 20 years but could be carried forward indefinitely to future tax years; however, the current two-year carryback of NOLs would generally be repealed.

Under the Senate bill only, the deduction for NOLs would be further reduced to 80% of taxable income for tax years beginning after December 31, 2022 (unless the revenue condition is satisfied). The 90% limitation in the House bill would apply permanently. In addition, unlike the House bill, the Senate bill does not include an inflation adjustment for amounts carried forward.

Under the Senate bill, the current rules for NOLs (*i.e.*, ability to carry back 2 years, carry forward 20 years, and offset 100% of taxable income) would continue to apply to property and casualty insurance companies.

Denial of nonrecognition for like-kind exchanges of personal property.

Each bill would limit nonrecognition treatment under section 1031 to like-kind exchanges of real property. Non-simultaneous transfers not completed by December 31, 2017 would be grandfathered, so long as the taxpayer has either received or disposed of the property to be exchanged on or before December 31, 2017.

UPDATE 12/02/17: Temporary full expensing of business assets; other cost recovery changes.

Temporary 100% expensing for certain business assets.

Each bill would permit 100% expensing of the cost of certain business property placed into service after September 27, 2017 and before January 1, 2023. The House bill would allow immediate expensing for both new and used eligible property, whereas the analogous Senate provision would only apply to new property. Additionally, beginning in 2023, under the Senate bill only, the immediate first-year expensing would be reduced to 80%, followed by 60% in 2024, 40% in 2025, and 20% in 2026. Under both bills, immediate expensing would be available only to taxpayers subject to the proposed section 163(j) interest limitation. Therefore, real estate trade and businesses electing out of section 163(j) would not be entitled to immediate expensing under this provision.

Reduction of cost recovery periods for residential rental and nonresidential real property.

The Senate bill would reduce cost recovery periods for residential rental and nonresidential real property from, respectively, 27.5 years and 39 years to 25 years in both cases. The House bill does not contain an analogous provision.

Expansion of section 179 expensing.

The Senate bill permits immediate expensing for up to $1,000,000 of the cost of qualifying tangible personal property placed into service after December 31, 2017, an increase from the $500,000 cap under current law, but less than the House bill's proposal to allow expensing of up to $5 million (although the Senate provision would apply to more types of property, including an expanded category of qualified real property). The benefit under the Senate bill would be reduced (but not below zero) to the extent the value of qualifying property placed into service exceeded $2,500,000 for the tax year (compared to $2 million under current law and $20 million under the House bill). The expansion would be permanent under the Senate bill but would expire for tax years beginning after December 31, 2023 under the House bill.

Required amortization for specified research and experimental expenditures.

Effective for tax years beginning after December 31, 2025, the Senate bill would require taxpayers to capital and amortize certain research and experimental expenditures (including software development costs) which, under current law, are immediately deductible. The cost recovery period for these expenditures would be 5 years if related to research conducted within the United States, and 15 years if conducted outside of the United States. The House bill contains a substantially similar provision but would go into effect for tax years beginning after December 31, 2022—three years earlier than the Senate bill. Both the House and the Senate bills specifically apply to software development expenditures.

Modification of accounting methods for taxpayers with gross receipts of $15 million or less.

The Senate bill would generally permit taxpayers with gross receipts not exceeding $15 million for the three prior tax years (the "$15 million gross receipts test") to elect to use the cash method of accounting. (The House bill would increase this maximum threshold to $25 million; the maximum under current law is $5 million.) The current exceptions from the required use of accrual accounting for certain categories of taxpayers—including taxpayers that do not satisfy the $15 million gross receipts test—would remain.

Taxpayers satisfying the $15 million gross receipts test would not be required to comply with the specific inventory accounting rules imposed under current section 471 but could instead determine cost of goods sold applying their financial accounting method. Additionally, taxpayers meeting this test would be exempt from the uniform capitalization rules under section 263A and, if additional requirements are satisfied, from required use of the percentage-of-completion method of calculating taxable income from certain small construction contracts.

Taxpayers satisfying the $15 million gross receipts test would not be subject to the limitation on net interest expense deductions, discussed above.

UPDATE 12/02/17: Repeal of the domestic production activities deduction and other business deductions and credits.

Both bills would repeal the deduction for domestic production activities under section 199, although the House bill would make this effective for tax years beginning after December 31, 2017, while the Senate bill would delay the effective date for taxpayers that are C corporations until tax years beginning after December 31, 2018.

The House and Senate bills would also repeal or substantially limit the orphan drug credit and the property rehabilitation credit. The House bill (but not the final Senate bill) would repeal the deduction for unused business credits.

UPDATE 12/02/17: 23% deduction for qualified business income of certain pass-through business owners; other changes to pass-through taxation.

23% deduction (equivalent to a 29.645% maximum effective rate) for "qualified business income" earned by pass-through entities.

The Senate bill provides for a maximum effective rate of 29.645% on an individual's domestic "qualified business income" from a partnership, S corporation, or sole proprietorship. Amounts received as dividends from real estate investment trusts ("REITs") and the qualified trade or business income from a "qualified publicly traded partnership" would also be eligible for this deduction. The reduced rate arises from a 23% deduction ([100% – 23%] * 38.5% proposed maximum rate = 26.945%) and is lower than the rate proposed in the Senate Finance Committee bill, which provided for a 17.4% deduction and a top marginal rate of 31.8%. Qualified business losses would carry forward to the next tax year, and presumably would reduce the amount of qualified business income included in determining the amount of the deduction for that year.

The deduction would not be available to owners of "specified service businesses" (or "specified service trades or businesses" under the Senate bill) except for taxpayers with taxable income below a given threshold ($500,000 for married individuals filing jointly and $250,000 for single taxpayers under the Senate bill, phasing out completely at $600,000 and $300,000, respectively). Specified service businesses include any trade or business activity involving the performance of services in the areas of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any other trade or business the principal asset of which is the reputation or skill of its employees. Qualified business income would not include most investment income.

The amount of the deduction available to a taxpayer from a partnership or S corporation could not exceed 50% of the taxpayer's share of the W-2 wages paid by the pass-through for the tax year, and only those wages "properly allocable to qualified business income" could be taken into account. However, under the Senate bill, the W-2 wage limitation would not apply to individuals with taxable incomes at or below $500,000 for married individuals filing jointly or $250,000 for single individuals, and would phase-in completely over the next $100,000 or $50,000, as applicable, of taxable income. Under the final Senate bill, qualified business income earned through a publicly traded partnership and otherwise eligible for the deduction would not be subject to the W-2 wage limitation.

The Senate approach differs from that of the House, which would tax qualified business income at 25% (or 9% for certain qualified business income earned by taxpayers with taxable income below a threshold). In the case of active trade or business income, the House bill would presume that 70% of income derives from labor and therefore only 30% would be entitled to the reduced rate, effectively taxing the active income at a blended 35.22% rate. In addition, the 23% deduction in the Senate bill is limited to qualified business income that is effectively connected with a U.S. trade or business within the meaning of section 864. Therefore, pass-through income that is not ECI would not qualify for the deduction. The House bill does not contain a similar limitation.

Limitation on active pass-through losses.

Under the Senate bill (but not the House bill), deductions for "excess business losses" of flow-through taxpayers (*i.e.*, taxpayers other than C corporations) would not be permitted to offset non-business income of the taxpayer. These losses would be treated as NOLs and carried forward into subsequent tax years. An "excess business loss" is defined as the excess of a taxpayer's aggregate deductions attributable to trades or business of the taxpayer over the sum of the taxpayer's aggregate gross income plus a threshold amount ($500,000 for married individuals filing jointly and $250,000 for single individuals, indexed for inflation). The determination whether a net business loss exceeds the threshold amount is made at the individual partner or S corporation shareholder level.

Changes to partnership taxation.

The Senate bill (but not the House bill) modifies the definition of substantial built-in loss for purposes of section 743(d), which under current law requires a partnership to adjust the basis of partnership assets with substantial built-in losses upon transfer of an interest in the partnership. Under the proposed change, a substantial built-in loss would exist if, immediately after the transfer of the partnership interest, a liquidation of the partnership would result in an allocation of loss to the transferee in excess of $250,000.

A partner's distributive share of partnership charitable contributions and foreign taxes paid would also be limited to the partner's adjusted basis in its partnership interest.

Extended 3-year holding period required for carried interests.

Under the Senate bill, as well as the House bill, holders of carried interests would be required to satisfy a 3-year holding period (rather than the one-year period under current law) to qualify for long-term capital gains rates in respect of profits interests received in exchange for services. This provision was added to the Senate bill by the Chairman's amendment, which contains little detail. Assuming it operates the same way as the analogous provision in the House bill, the rule would apply to a partnership that is engaged in a trade or business conducted on a regular, continuous, and substantial basis and the business consists of either the development of certain specified assets, or the investment in and/or disposition of specified assets (including identification of specified assets for investment and/or disposition). "Specified assets" include securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts, and an interest in a partnership to the extent attributable to specified assets.

II. Foreign income provisions.

UPDATE 12/02/17: One-time tax of 7.5%/14.% on deemed repatriated foreign earnings.

The Senate bill imposes a one-time tax on a U.S. shareholder's pro rata share of the accumulated, undistributed earnings of "specified 10% owned foreign corporations" of which it is a 10% or more shareholder. Earnings of a specified 10% owned foreign corporation attributable either to U.S. effectively connected income ("ECI") or to dividends received directly or indirectly from 80%-owned U.S. corporations would be excluded. The tax rates proposed in the final Senate bill would be 14.5% of earnings attributable to cash assets and 7.5% of earnings attributable to noncash assets, compared with 14% and 7%, respectively, under the House bill and 10% and 5%, respectively, under the original Senate Finance Committee proposal. The deemed repatriations giving rise to this tax would occur during the foreign corporation's last tax year beginning before January 1, 2018.

Under each bill, the tax would be payable over an 8-year period at the taxpayer's election. REITs would be permitted to elect to meet their distribution requirements with respect to accumulated untaxed foreign earnings over this same 8-year period using the same annual installment percentages. The deemed repatriated earnings would be excluded for purposes of the REIT's gross income tests.

Additionally, under the Senate bill, U.S. shareholders would be able to net foreign E&P deficits and qualified deficits against untaxed earnings to determine the amount of inclusion. U.S. shareholders would also be able to choose whether to offset their foreign NOLs against the amount deemed included in the repatriation, or whether to preserve these NOLs to offset future tax liability.

Recapture tax on expatriated entities.

Under the Senate bill (but not the House bill), if a U.S. corporate shareholder becomes an "expatriated entity" within the 10-year period following enactment of the proposed legislation, the reduced tax rate applicable to its share of any foreign earnings deemed repatriated by virtue of this provision would be retroactively increased to 35%. The amount of additional tax due would be computed by reference to the year of the deemed inclusion (which for calendar year taxpayers would be 2017), but would be assessed in the year of the U.S. shareholder's expatriation.

Shift to territorial system of international taxation through deduction of foreign source dividends.

The Senate bill, like the House bill, would shift the current U.S. “worldwide” international tax system, under which U.S. companies are taxable on worldwide income, to a “territorial” system under which foreign active profits are generally exempt from tax. The mechanism under both bills would be generally to exempt the foreign-source portion of dividends paid by a foreign corporation to a U.S. corporate shareholder that owns 10% or more of the foreign corporation (referred to here as a “U.S. corporate shareholder”), provided the recipient satisfies a holding period requirement with respect to the underlying stock.

No foreign tax credit or deduction would be permitted for any exempt foreign-source dividend, and neither the exempt dividend nor deductions allocable to the foreign-source portion of the underlying stock would be considered in calculating the foreign tax credit limitation of the U.S. corporate shareholder. A U.S. corporate shareholder’s basis in the foreign corporation stock would be reduced solely for purposes of determining a loss on later disposition of the stock.

Gain from the of stock of a foreign corporation by a U.S. corporate shareholder that has been held for at least one year would be treated as a dividend for purposes of calculating any foreign-source deduction. Similar rules would apply to treat gain from the sale by a CFC of stock in a lower-tier CFC as a dividend to the U.S. shareholder of the selling CFC.

Foreign-source dividend deduction disallowed for hybrid dividends and dividends from PFICs and inverted corporations.

Under the Senate bill (but not the House bill), the deduction for foreign-source dividends would not be available for “hybrid dividends” received by a U.S. corporate shareholder from a controlled foreign corporation (a “CFC”). Accordingly, repatriated hybrid dividends would be taxable. A hybrid dividend is any payment received from a foreign corporation for which the foreign corporation received a deduction or other tax benefit with respect to foreign taxes if the payment would otherwise be deductible under the proposal.

Hybrid dividends between CFCs sharing a common 10% U.S. corporate shareholder would be treated as subpart F income of the recipient CFC and included in the income of that 10% U.S. corporate shareholder in the same tax year.

In addition, the Senate bill specifically disallows any foreign-source deduction with respect to dividends received from passive foreign investment companies ("PFICs") or "inverted" entities (i.e., entities meeting the definition of "surrogate foreign corporations" in section 7874).

Transferred loss recapture rules.

Under both bills, transferred loss recapture rules would apply to transfers of substantially all of the assets of a domestic corporation's foreign branch to a foreign corporation in which the domestic transferor is a U.S. corporate shareholder.

10% tax on "global intangible low-taxed income" ("GILTI").

Notwithstanding the general territoriality rule, the Senate bill would tax a U.S. shareholder's share of a CFC's "global intangible low-taxed income," or "GILTI," at a special 10% rate (which would increase to 12.5% for tax years beginning after December 31, 2025 if the revenue condition is not met). Very generally, GILTI is active (non-Subpart F) income in excess of an implied return of 10% of the CFC's adjusted bases in tangible depreciable property used to generate the active income. The House bill has a similar concept but applies to income in excess of the short-term federal rate plus 7%, multiplied by the same base amount.

More specifically, a U.S shareholder's GILTI is measured as the excess (if any) of its aggregate pro rata share of "net CFC tested income" over a deemed tangible income return of 10% on its aggregate pro rata share of the CFCs' "qualified business asset investment," or "QBAI" (generally, depreciable tangible property used in the production of tested income). "Net CFC tested income" generally means the aggregate of a U.S. shareholder's pro rata share of "active" net income (or loss) from each CFC of which it is a U.S. shareholder (*i.e.*, Subpart F income, effectively-connected income, foreign oil and gas income, and certain other categories of income are excluded). The mechanism for arriving at the special 10% rate is a 50% deduction: (100% GILTI inclusion – 50% deduction) * 20% corporate tax rate = 10%. This deduction would be decreased to 37.5% in tax years beginning after December 31, 2025, unless a revenue condition is met.

GILTI would be treated similarly to subpart F income (and so would be includible currently to any United States shareholder). U.S. corporate shareholder with GILTI inclusions would be permitted a foreign tax credit equal to 80% of its ratable share of foreign taxes deemed paid attributable to net CFC tested income. Non-passive GILTI would be in a separate foreign tax credit basket, with no carryforward or carryback available for excess credits.

Reduced 12.5% "patent box" rate for "foreign-derived intangible income."

Under the Senate bill (but not the House bill), a special 12.5% rate (increasing to 15.625% in tax years beginning after December 31, 2025) would apply to the intangible income of a U.S. corporation derived in connection with foreign sales or foreign use (the corporation's "foreign derived intangible income," or "FDII"). The House bill does not have an analogous concept.

Mechanically, the proposal permits a 37.5% deduction for "foreign-derived intangible income" ("FDII"). A 37.5% deduction results in a net tax of 12.5% ([100% – 37.5%] * 20% = 12.5%).[3] FDII is the amount that bears the same ratio to the corporation's "deemed intangible income" ("DII") as its "foreign-derived deduction eligible income" ("FDDEI") bears to its "deduction eligible income" ("DEI").

DEI is the gross income of a U.S. corporation (after deductions), excluding any subpart F income of the corporation includible under section 951, the corporation's GILTI, dividends received from CFCs with respect to which the corporation is a United States shareholder, domestic oil and gas income, and the corporation's foreign branch income.

DII is equal to the excess of the corporation's DEI over its "deemed tangible income return," which is 10% of the corporation's qualified business asset investment (defined the same for FDII purposes as for GILTI purposes, discussed above). Finally, FDDEI is DEI that is derived in connection with (1) property that is sold by the taxpayer to any person that is not a United States person and is for foreign use or (2) services provided by the taxpayer to any person, or with respect to property, that is not located in the United States.

The provision is generally designed to provide an incentive for U.S. corporations to retain their intellectual property in the United States rather than to transfer it to a foreign affiliate, which would develop the intellectual property and license it to third parties. However, because the reduced 12.5% tax rate applicable to FDII is still not as low as the 10% applicable GILTI, an incentive would still exist under the Senate bill to develop intellectual property abroad rather than in the United States.[4] An earlier description of the Senate bill published by the JCT on November 9, 2017 suggested that FDII and GILTI would be taxable at the same rate.

Under the modified Senate bill, the deduction for FDII would decrease to 21.875% (and the effective tax rate on FDII would increase to 15.625%) for tax years beginning after December 31, 2025.

Three-year tax-free distribution of intangibles by CFCs.

Under the Senate bill (but not the House bill), a CFC (and therefore its United States shareholders) would not recognize gain on the distribution of intangible property to a United States shareholder that is a corporation if made by the CFC before the last day of the third tax year of the CFC beginning after December 31, 2017. This provision would allow U.S. multinationals to repatriate their intellectual property on a tax-deferred basis if within this three-year window.

"United States shareholder" to include *any* United States person that owns 10% or more of the value of a foreign corporation; downward attribution from a foreign person to a related U.S. person.

Under current law, a United States shareholder is defined as a United States person that owns more than 10% of the voting power of a foreign corporation. The Senate bill (but not the House bill) would change the definition so that any U.S. person that owns shares worth 10% or more of the total value of all classes of stock of a foreign corporation would be a "United States shareholder" of that corporation required to include in income its share of the corporation's subpart F income if that corporation were a CFC. This change would represent a fundamental expansion of the CFC rules that have been in place since 1962.

Both bills would provide for expanded downward attribution from a foreign person of its stock in a foreign corporation to a related U.S. person for purposes of determining whether the U.S. person is a United States shareholder and whether the foreign corporation is a CFC. A United States shareholder's ratable share of a CFC's subpart F inclusion would be determined without regard to this attribution.

These changes would be effective under the Senate bill for the last tax year of a foreign corporation beginning before January 1, 2018 and for tax years of United States shareholders ending with or within the tax year of the foreign corporation. Under the House bill, the change to downward attribution would be effective for tax years beginning after December 31, 2017.

Repeal of section 956 for U.S. corporate shareholders; look-through rule for related CFCs made permanent in 2020.

The Senate bill (as well as the House bill) would repeal section 956 with respect to a corporate United States shareholder of a CFC. Accordingly, the United States shareholder would not include in income its share of the CFC's earnings invested in "United States property." Indirect corporate United States shareholders of CFCs that hold their CFC interests through a domestic partnership would also be eligible for this exemption.

Foreign base company oil-related income would be removed from the subpart F regime, withdrawals of excluded subpart F income from qualified shipping operations would no longer give rise to subpart F inclusions, and the amount of foreign base company income considered *de minimis* ($1 million in 2017) would be indexed for inflation.

The look-through rule for payments of dividends, interest and equivalents, rents, and royalties from one CFC to another CFC would also be made permanent for tax years of foreign corporations beginning after December 31, 2019.

UPDATE 12/02/17: Proposals to prevent base erosion.

Base erosion minimum tax imposed on large C corporations.

The Senate bill would impose a 10% “base erosion anti-abuse tax” (BEAT) equal to roughly the excess of 10% over the difference between a taxpayer’s actual tax liability over the tax liability it would had if payments to foreign affiliates were not deductible, property purchased from foreign affiliates was not depreciable, and payments to foreign parents of inverted companies were not deductible. The minimum tax would be increased to 12.5% in tax years beginning after December 31, 2025. The final Senate bill increases the rates applicable to banks and securities dealers to 11% for tax years beginning after December 31, 2017 and 13.5% for tax years beginning after December 31, 2025.

Specifically, the Senate bill would require a corporate taxpayer to pay an amount equal to the excess of 10% of the taxpayer’s “modified taxable income” for the tax year over an amount of “regular tax liability,” subject to certain adjustments. “Modified taxable income” is defined as the taxpayer’s taxable income under chapter 1, determined without regard to any “base erosion tax benefit” or “payment” or the “base erosion percentage” of any allowable NOL deduction. A “base erosion payment” would generally include any amount paid or accrued by a taxpayer to a related foreign party if the payment is either deductible or subject to the allowance for depreciation, as well as any reduction in gross receipts due to a payment or accrual to a related surrogate foreign corporation or a member of its expanded affiliated group. Related parties include a 25% owner of the taxpayer, any person related to the taxpayer or the 25% owner under the attribution rules of sections 267(b) and 707(b)(1), and any person related to the taxpayer for purposes of section 482. Additional reporting requirements would also be imposed.

Under the Senate bill, payments to related parties for services that satisfy the services cost method under the section 482 transfer-pricing rules (assuming no additional markup), as well as “qualified derivate payments” for mark-to-market taxpayers, would not be considered base erosion payments. (The House bill contains a similar exception to its proposed 20% excise tax, discussed below, for deductible payments made for intercompany services paid at cost.) Payments includible as subpart F income or subject to the GILTI tax would potentially be subject to the BEAT also.

The base erosion minimum tax would only apply to taxpayers that are corporations (other than a RIC, a REIT, or an S corporation) with average annual gross receipts equal to or exceeding $500 million, and would only apply if at least 4% of the taxpayer's deductions related to payments to related foreign persons. The provision applies to U.S. corporations and also to foreign corporations engaged in a U.S. trade or business for purposes of determining the tax due on their effectively connected income (ECI).

The House bill instead would impose a 20% excise tax on certain payments made by U.S. corporations to related foreign corporations in the same international financial reporting group if the payments are deductible, includible in cost of goods sold, or eligible for depreciation or amortization. (This excise tax would not apply to a recipient corporation that elects to treat the payments received as income effectively connected with a U.S. trade or business carried on by the recipient corporation through a permanent establishment in the United States.)

UPDATE 12/02/17: Limit on disproportionate net interest expense deductions for U.S. members of worldwide affiliated groups; proposed transition.

The Senate bill would limit the net interest expense deductions of a U.S. corporation that is a member of a worldwide affiliated group based on the amount by which the total U.S. group indebtedness exceeds 110% of the debt the U.S. group would have if all members of the worldwide affiliated group had proportionate debt-to-equity ratios ("excess domestic indebtedness"). The final Senate bill introduces transition rules that would initially set the threshold for excess domestic indebtedness at 130%, and gradually reduce this to 110% for tax years beginning after December 31, 2021.

The House bill would similarly limit a U.S. corporation's net interest expense deduction to 110% of the U.S. corporation's proportionate share of the EBITDA of an "international financial reporting group" of which the U.S. corporation is a member, but would only apply to international financial reporting groups with annual gross receipts over $100 million. Unlike the Senate bill, the House provision does not contain a gradual phase-in.

Under both bills, a taxpayer subject to both this limitation and the proposed limitation on net business interest expense deductions under new section 163(j) would be subject to the more restrictive of the two limitations. Disallowed interest expense deductions could be carried forward indefinitely under the Senate bill (compared with only 5 years under the House bill).

Changes to section 482 transfer-pricing rules with respect to intangibles.

The Senate bill (but not the House bill) would also modify the definition of intangible property for purposes of sections 367 (relevant to outbound restructurings) and 482 (intercompany transfer pricing) to explicitly include workforce in place, goodwill, and going concern value. The proposal would codify the "realistic alternative" principle adopted by the IRS in regulations for determining the arm's length price for intangibles in an intercompany transaction and would authorize the IRS to require an aggregate method of valuating intangibles. These changes would appear to reverse the Tax Court's recent decision in *Amazon.com v. Commissioner*,[5] currently on appeal to the Ninth Circuit.

Denial of deductions for amounts paid or accrued to related parties that are hybrid entities.

Under the Senate bill, deductions for amounts of interest or royalties paid or accrued to a related party would be disallowed if the payment or accrual was either (1) not included in income under the tax law of the recipient's country of residence, or (2) deductible by the recipient under the tax law of the recipient's country of residence. The House bill instead would impose a general 20% tax on deductible payments to related foreign entities (regardless of whether deductible in the recipient country). The Senate bill authorizes the Treasury generally to issue regulations addressing hybrid transactions.

Dividends from surrogate foreign corporations not eligible for QDI treatment.

Dividends received by individuals with respect to stock owned in "surrogate foreign corporations" would not be eligible for reduced tax rates applicable to "qualified dividend income" (generally, long-term capital gains rates if holding periods are satisfied).

Changes to foreign tax credit system.

Both the Senate and House bills repeal the deemed-paid credit on dividends received by a 10% U.S. corporate shareholder of a foreign corporation. Instead, a deemed-paid credit would be provided for any income inclusion under subpart F (but only to the extent properly attributable to the subpart F inclusion). Foreign branch income, which generally includes business profits allocable to a qualified business unit but excludes passive category income, would be allocated to its own foreign tax credit basket. The final Senate bill introduces a provision that would allow taxpayers to accelerate the recapture of unused overall domestic losses (incurred in any tax year beginning before January 1, 2018), which could then be offset with any unused foreign tax credits of the taxpayer.

Sources of income and expenses.

Source of inventory sales determined solely based on the location of production activities.

The determination of the source of income from inventory sales would be based solely on the location of production activities (and allocated among two or more jurisdictions, where appropriate).

Effective date of the worldwide interest allocation rules accelerated to 2018.

The long-deferred effective date of the previously enacted worldwide interest allocation rules would be advanced three years to apply to tax years beginning after December 31, 2017.

Treatment of foreign insurance companies as PFICs unless loss, loss adjustment expenses, and reserves constitute 25% of total assets.

Under the Senate bill (as well as the House bill), the determination whether a foreign insurance company is a passive foreign investment company (PFIC) would be based on the company's insurance liabilities. Under the proposal, a foreign insurance company would generally be treated as a PFIC unless (1) the foreign company would be taxed as an insurance company were it a U.S. corporation and (2) the company's loss and loss adjustment expenses and certain reserves constitute more than 25% of the foreign corporation's total assets as represented on the company's GAAP (or equivalent) financial statements. The 25% threshold could be reduced to 10% in certain situations if a U.S. owner of the company so elects and the failure to reach the 25% threshold is due to circumstances specific to the insurance business.

Codification of Revenue Ruling 91-32; treatment of gain on the sale of an interest in a partnership that is engaged in a trade or business in the United States as income that is effectively connected with a U.S. trade or business.

The Senate bill would reverse the recent Tax Court decision *Grecian Magnesite Mining v. Commissioner*,[6]and would thus effectively codify Revenue Ruling 91-32, by treating gain or loss from the sale of an interest in a partnership as income that is "effectively connected" with a U.S. trade or business to the extent attributable to a trade or business of the partnership in the United State. Specifically, the Senate bill would treat the sale of a partnership interest as a sale of all of the partnership's assets for their fair market value as of the date of sale, and would determine the amount of effectively connected gain or loss allocable to the selling partner based on the amount that would be allocated to that partner in a hypothetical liquidation. The House bill does not contain a similar provision.

The Senate bill would also require the transferee of a partnership interest to withhold 10% of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that it is neither a nonresident alien nor a foreign corporation.

III. Individuals.

Nearly all individual changes to expire after December 31, 2025; ACA individual mandate repealed.

Under the modified Senate bill, individuals lacking minimum health coverage mandated by the Affordable Care Act (ACA) would no longer be required to make shared responsibility contributions (commonly known as the "individual mandate"). This would effectively repeal the individual mandate, a central pillar of the ACA.

In addition, the modified Senate bill generally provides that all proposed changes to individual taxation will sunset in tax years beginning after December 31, 2025. (This includes generally all provisions discussed in this Part III—Individuals.) The two exceptions to this general expiration are repeal of the ACA individual mandate and the transition to "chained CPI-U" for indexing inflation. Like the House bill, the Senate bill would adjust the capital gain and ordinary income brackets for inflation based on chained CPI-U, a method generally thought to increase the brackets at a slower rate than currently and may shift taxpayers into higher brackets over time.

Retains seven bracket structure with adjustments (10%; 12%; 22%; 24%; 32%; 35%; 38.5%)

The Senate bill would retain a seven bracket structure, as currently, adjusting the brackets and modestly and reducing the top rate from 39.6% to 38.5%. The modified Senate bill reduced rates modestly in several brackets (from 22.5%, 24.5%, and 32.5% to 22%, 24% and 32%, respectively). Taxpayers currently in the 10% bracket would remain in the 10% bracket. (The House bill would reduce the number of brackets from seven to four, increase the rate applicable to lowest bracket from 10% to 12%, and retain the top bracket at 39.6%.) Unlike the House bill, the Senate bill does not contain the 6% "surtax" (*i.e.*, the recapture of the 12% rate) for high income taxpayers. The Senate bill also retains a separate rate structure for heads of household; the House bill does not. A comparison of the proposed rate structures in the House and Senate bills to current law is illustrated in the chart below.

Single individuals

Current Law		**Senate Bill**	
Taxable income between:	**Marginal tax rate**	**Taxable income between:**	**Margin**
0 – $9,525	10%	0 – $9,525	10%
$9,526 – $38,700	15%	$9,526 – $38,700	12%
$38,701 – $93,700	25%	$38,701 – $70,000	22%
$93,701 – $195,450	28%	$70,001 – $160,000	24%
		$160,001 – $200,000	32%
$195,451 – $424,950	33%	$200,001 – $500,000	35%
$424,951 – $426,700	35%		
Over $426,700	39.6%	Over $500,000	38.5%

Married filing jointly

Current Law		**Senate Bill**	
Taxable income between:	**Marginal tax rate**	**Taxable income between:**	**Margi**
0 – $19,050	10%	0 – $19,050	10%
$19,051 – $77,400	15%	$19,051 – $77,040	12%
$77,401 – $156,150	25%	$77,041 – $140,000	22%
$156,151 – $237,850	28%	$140,001 – $320,000	24%
$237,951 – $424,950	33%	$320,001 – $390,000	32%
$424,951-$480,050	35%	$390,001 – $1,000,000	35%
Over $480,050	39.6%	Over $1,000,000	38.5%

The current maximum rates for net long-term capital gains (including qualified dividend income) would be retained, as would be the 25% rate applicable to unrecaptured section 1250 gain and the 28% rate on 28%-rate gain. The 3.8% tax on net investment income (also known as the "Medicare tax") is retained.

Increased standard deduction; repeal of personal exemptions.

The Senate bill would increase the 2018 standard deduction from $6,500 to $12,000 for individuals, from $9,350 to $18,000 for heads of household, and from $13,000 to $24,000 for married couples, to be adjusted for inflation based on chained CPI-U starting in tax years after December 31, 2017. (The House bill would increase the brackets to $12,200 and $24,400, respectively.) Like the House bill, the Senate bill would repeal personal exemptions ($4,150 for each exemption in 2018 under current law). Taxpayers with gross income below the applicable standard deduction would not be required to file U.S. federal income tax returns.

This increase in the standard deduction is expected to simplify tax filings for millions of low-and middle-income families. However, because the charitable deduction is available only for taxpayers who itemize, the increased standard deduction would tend to reduce charitable contributions.

Expanded child tax credit; new non-child dependent credit.

The modified Senate bill would further increase the child tax credit to $2,000 (compared to $1,600 in the original Senate bill) from $1,000 under current law. (The House bill would increase the credit to $1,650.) Under the modified Senate bill, the phase out for the credit would begin at incomes equal to or exceeding $500,000 for married individuals filing jointly ($250,000 for single individuals), rather than the $1 million threshold for joint filers previously proposed. However, the reduced threshold is considerably more generous than the thresholds under both current law and the House bill ($115,000 and $230,000, respectively, for married individuals filing jointly). The Senate bill would provide a $500 nonrefundable credit for all non-child dependents which would not expire (compared to a $300 credit per member of the household under the House bill, which would expire after 2022).

UPDATE 12/02/17: Individual Alternative Minimum Tax (AMT) retained with increased exemption thresholds.

The House bill would repeal the individual AMT in its entirety. The final Senate bill retains the individual AMT but increases the AMT exemption amounts to $109,400 from $78,750 (for joint filers) and to $70,300 from $50,600 (for single individuals), and increases the phase-out threshold to $208,400 from $150,000 (for joint filers) and to $156,300 from $112,500 (for single individuals).

UPDATE 12/02/17: Limitations, repeals, and other changes to individual itemized deductions.

Repeal of the "Pease" limitations on deductions.

Both the Senate bill and House bill would repeal the Pease limitation on deductions, which under current law effectively amount to a 1.18% marginal tax (3% x 39.6%) for certain high-income taxpayers.

Increased charitable deduction.

Under current law, cash contributions to a public charity are deductible only to the extent of 50% of the taxpayer's adjusted gross income (AGI). Both the Senate bill and House bill would increase this limit to 60% of AGI.

UPDATE 12/02/17: Deduction for state and local income taxes repealed; deduction preserved for up to $10,000 of state and local property taxes paid.

Both the House and Senate bills would repeal the deduction for state and local income taxes but would permit a deduction of up to $10,000 for state and local property taxes paid. The loss of deduction for state and local income taxes would have the greatest impact on individuals living in high-tax states and municipalities, such as New York State, California, Massachusetts, and New Jersey.

Taxes paid or accrued in carrying on a trade or business or section 212 activity (relating to the production of income) that are presently deductible in computing income on an individual's Schedule C, Schedule E, or Schedule F would continue to be deductible. (These taxes include real estate and personal property taxes on business assets, highway use taxes, licenses, regulatory fees, and similar items.) While state and local income taxes imposed on individual owners of a partnership or other pass-through business would not be deductible, it appears that, under the Senate bill, entity-level taxes that are taken into account in determining a pass-through owner's distributive share of pass-through income would continue to be deductible.

UPDATE 12/02/17: Temporary increase to medical expense deduction.

The final Senate bill would allow a deduction for unreimbursed medical expenses in excess of 7.5% of AGI for tax years beginning after December 31, 2016 and ending before January 1, 2019. For tax years beginning January 1, 2019 or later, the medical expense deduction would only be allowed to the extent such expenses exceed 10% of AGI, as under current law. The House bill would repeal the medical expense deduction entirely for tax years beginning after December 31, 2017.

Limitation on home mortgage interest deduction.

The Senate bill retains the deduction for home mortgage interest accrued on acquisition indebtedness of up to $1 million. (The House bill would have reduced the cap on principal to $500,000.) Both the Senate and House versions would repeal the deduction for interest on home equity indebtedness.

Repeal of casualty and theft loss deduction except for presidential declared major disasters.

The Senate bill generally repeals individual deductions for personal casualty and theft losses, with limited exceptions for certain officially recognized disasters. The House bill would eliminate this deduction entirely except with respect to individual personal casualty losses arising from hurricanes Harvey, Irma, and Maria.

Wagering loss limitation.

Under both bills, deductions for wagering losses would only be allowed to the extent of wagering gains from the same tax year.

Repeal of miscellaneous itemized and other deductions.

The Senate bill would generally repeal miscellaneous itemized deductions subject to the 2% AGI floor under current law (*e.g.*, deductions for the production or collection of income, unreimbursed expenses attributable to the trade or business of being an employee, repayments of income received under a claim of right, repayments of Social Security benefits, etc.). The House bill does not repeal miscellaneous itemized deductions. The deductions for tax preparation expenses and moving expenses would also be repealed.

Unlike the House bill, the Senate bill retains the deductions for student loan interest.

Repeal of certain individual exclusions from income.

The Senate bill would repeal the exclusions from income under current law for qualified moving expense reimbursements and qualified bicycle commuting reimbursements. (The House bill would retain the exclusion for qualified moving expenses for members of the armed services.)

The current law exclusion of gain on sale of a personal residence ($250,000 for a single individual, $500,000 for married individuals filing jointly) would only be available to individuals who have owned and used the residence as a principal residence for at least 5 of the 8 years preceding the sale (subject to certain exceptions), compared with a 2-year use and ownership requirement under current law. The House bill would retain the current-law 2-year use and ownership requirement, but would phase out the exclusion beginning at incomes greater than $250,000 for a single individual or $500,000 for married individuals filing jointly. Both bills would limit the availability of the exclusion to one sale or exchange during a 5-year period.

The denial of an income exclusion for discounted tuition benefits received by university employees and their family members, proposed in the House bill, does not appear in the Senate bill.

Estate and generation-skipping transfer taxes retained with increased exemption amount.

Unlike the House bill, which would repeal the estate tax fully after 2024, the Senate bill would retain the tax but double the estate and gift tax exemption amounts from $5 million per person under current law to $10 million (both current and proposed exemption amounts indexed for inflation occurring after 2011). The proposal would be effective for generation-skipping transfers, gifts made, and estates of decedents dying after December 31, 2017.

The income tax basis of inherited property would continue to be adjusted to fair market value at death under both the House and Senate bills.

Roth re-characterizations disallowed.

Both bills would eliminate the ability of an individual to recharacterize either a traditional IRA contribution as a Roth IRA contribution or a Roth IRA contribution as a traditional IRA contribution (which, under current law, is permitted for a limited period of time after the contribution is made).

IV. Employee benefits and executive compensation.

Loss of deduction for performance pay over $1 million.

The Senate bill, like the House bill, would amend section 162(m), which under current law imposes a $1 million limit on the annual compensation deduction for any "covered employee," in several significant ways. First, both proposals eliminate the exemption for "performance-based" compensation currently relied upon by a majority of publicly held corporations paying executive officers annual compensation exceeding $1 million.

Second, the Senate bill, like the House bill, modifies the definition of "covered employee" to include the principal executive officer and principal financial officers of the company at any time during the tax year, as well as the three highest paid employees of the company (excluding the principal executive office and principal financial officer). An individual who becomes a covered employee for any taxable year beginning after December 31, 2016 would continue to be a covered employee in subsequent years, even if the individual is no longer an employee of the company or is deceased.

Third, the Senate bill, like the House bill, expands the number of corporations subject to the limitation to include all domestic publicly traded corporations and all foreign companies publicly traded as American depository receipts (ADRs). While the limit in section 162(m)(1) is currently applicable to publicly held corporations only, the Senate bill suggests that the limitation may also apply to "certain additional corporations that are not publicly traded, such as large private C or S corporations," although details are not specified.

The Senate bill provides transition relief by grandfathering remuneration paid under a written, binding contract in effect on November 2, 2017, provided that the contract has not been materially modified since that time.

20% excise tax on excessive compensation paid by tax-exempt organizations.

The Senate bill, like the House bill, would impose a 20% excise tax on any compensation paid by most exempt organizations to their five highest paid employees in any given year ("covered employees") to the extent exceeding $1 million for the year. An individual who becomes a covered employee for any taxable year beginning after December 31, 2016 would continue to be a covered employee in subsequent years. Compensation for this purpose includes all cash and non-cash remuneration (including most benefits other than designated Roth contributions) as well as payments from persons or organizations related to the employer.

Certain severance "excess parachute payments" to covered employees would also be subject to the 20% excise tax. This applies to compensation payments that are contingent on a covered employee's separation from employment. If the parachute payments equal or exceed three times the employee's "base amount," then the 20% excise tax will apply to the portion of the parachute payments that are in excess of the employee's base amount. For this purpose, the "base amount" is determined by applying the current rules of section 280G, which generally provide that a covered employee's base amount is the individual's average annual taxable income from the organization over the five-year period immediately preceding the year in which the separation from service occurs (or any shorter period of service with the organization if less than five years).

New 5-year deferral election for certain forms of equity compensation.

The final Senate bill contains a provision, similar to that in the House bill, allowing "qualified employees" to make an elective 5-year deferral on income inclusion for equity compensation in the form of restricted stock units and stock options issued by private companies whose stock is not readily tradable and which have a written plan under which at least 80% of U.S. employees are granted equity compensation. Generally, an individual would not be a "qualified employee," and would instead be an "excluded employee," if the individual is or was a 1% owner of the corporation at any time during the last 10 years, is or was the CEO or CFO (or certain family members), or is or was one of the four highest paid officers of the corporation at any time during the last 10 years. The election to defer would have to be made within 30 days of the employee's right to stock becoming substantially vested or transferable, whichever is earlier, and would be made in a manner similar to an 83(b) election. Under the Senate bill, if a qualified employee makes an election to defer income inclusion on a restricted stock unit or stock option, earlier income inclusion would still be required if certain events occur (*e.g.*, the stock becomes transferable, the individual becomes an "excluded employee," or the company has an IPO).

UPDATE 12/02/2017: Proposal to standardize contribution limits for employer retirement plans eliminated.

The final Senate bill eliminates a proposal that would have standardized contribution limits among 401(k) plans, 403(b) plans, and governmental 457(b) plans.

Limitation on deductions associated with fringe benefits and entertainment expenses.

Both bills would generally disallow deductions with respect to entertainment and recreation activities, membership dues, and facilities used in connection with recreation or membership activities even if directly related to the active conduct of the taxpayer's trade or business. Deductions for expenses associated with providing any qualified transportation fringe or commuter transportation would generally be disallowed. The House bill, but not the Senate bill, would treat fringe benefits for which a deduction to taxable employer would be disallowed as unrelated business taxable income and would subject to the cost of these benefits to tax.

The Senate bill would limit the deduction for certain meals provided to employees for the convenience of the employer to 50% of the expenses incurred. The modified Senate bill would disallow the deduction entirely in tax years beginning after December 31, 2025.

V. Miscellaneous provisions.

First-in, first-out method used to determine basis in securities sold or exchanged.

Under the Senate bill, a taxpayer's basis in securities for purposes of calculating the gain or loss on the sale or exchange of securities would be determined on a first-in, first-out basis (subject to limited exceptions). Under current law, a taxpayer that is able to adequately identify the shares being sold is allowed to use the cost basis of the shares identified (known as "specific identification"). The specific identification method would no longer be available. The House bill does not contain a similar provision.

Regulated investment companies (RICs) would be exempt from this rule. Additionally, dispositions of securities currently eligible for the average basis method could continue to use this method to calculate gain or loss.

Acceleration of accruals to conform with financial accounting.

Under the final Senate bill, the all events test would be deemed to be satisfied with respect to an item when it is taken into account for financial accounting purposes on an audited financial statement (or similar statement as provided in regulations). Certain long-term contract income would not be subject to this rule. Taxpayers could continue to defer recognition of income associated with certain advance payment contracts as currently provided in Revenue Procedure 2004-34. The House bill does not contain a similar provision. The final Senate bill made certain technical corrections to the provision.

Limitation on deduction for FDIC premiums.

Under both the Senate and House bills, deductions for FDIC premiums paid by financial institutions with total consolidated assets worth $10 billion or more would be reduced by an increasing percentage based on the amount of total consolidated assets, with 100% of the deduction being disallowed for financial institutions with assets worth $50 billion or more. FDIC premiums are generally fully deductible under current law as ordinary and necessary business expenses.

Eligible beneficiaries of electing small business trusts to include nonresident aliens.

Under the modified Senate bill (but not the House bill), a nonresident alien would be eligible to be a potential current beneficiary of an electing small business trust ("ESBT"). While a nonresident alien is not permitted to hold an interest in an S corporation directly under current law, an ESBT can be a shareholder of an S corporation. Thus this change could allow nonresident aliens to hold indirect interests in S corporations.

The modified Senate bill also clarifies that the limits for charitable contributions applicable to individuals (including, for example, limits on percentage of income and carry forwards of deductions) apply to ESBTs.

VI. Tax-exempt organizations.

UPDATE 12/02/17: Excise tax on large private colleges and universities.

The Senate bill and the House bill would impose a 1.4% excise tax on the net investment income of private tax-exempt colleges and universities with at least 500 full-time, tuition-paying students and assets with an aggregate fair market value of at least $500,000 per student (excluding those assets used directly for purposes of educating students). The House bill (and an earlier version of the Senate bill) would set the per-student value threshold at $250,000 rather than $500,000.

UPDATE 12/02/17: No change to the "intermediate sanctions" excise tax.

The final Senate bill does not change the current law intermediate sanctions excise tax. The prior version would have imposed an additional excise tax on the organization and would have repealed the "rebuttable presumption" commonly relied-on by exempt organizations engaged in transactions with disqualified persons.

UPDATE 12/02/17: Proposal to tax royalty income from names and logos as UBTI removed from final Senate bill.

The final Senate bill does not change the unrelated business taxable income ("UBTI") rules relating to royalty income derived from the licensing of a tax-exempt organization's name or logo, as a prior version would have.

Separate netting required for unrelated trade or business activities.

The Senate bill also includes a provision requiring the computation of UBTI separately for each unrelated trade or business of the organization. (Under current law, income from all of an exempt organization's unrelated trade or business activities is calculated on an aggregate basis.) This change would prevent a tax-exempt organization from using expenses related to one trade or business to offset UBTI generated from another trade or business. Net operating losses could only be deducted against income from the specific trade or business from which the losses arose.

UPDATE 12/02/17: Tax-exempt status for professional sports leagues preserved in final Senate bill.

An earlier version of the Senate bill would have eliminated the tax exemption under section 501(c)(6) for sports leagues. This provision was removed from the final Senate bill.

Repeal of exemption for advanced refunding bonds; exemption for private activity bonds retained.

The Senate bill ends the tax exemption for interest earned on "advanced refunding bonds," which under current law are used to refinance tax-exempt bonds issued by state and local governments and certain charitable activities of section 501(c)(3) organizations. The repeal would apply to advanced refunding bonds issued after December 31, 2017.

The Senate bill, unlike the House bill, does not include a general repeal of the exemption for interest earned on private activity bonds.

UPDATE 12/02/17: Exception to private foundation excess business holdings rules for philanthropic businesses removed in final Senate bill.

Under current law, a 5% excise tax is imposed on the value of certain "excess business holdings" held by a private foundation if not disposed of within a set period. This tax may increase to 200% if the 5% tax is imposed on a private foundation and the foundation does not dispose of the excess business holdings within the applicable tax year. The House bill would exempt certain philanthropic business holdings from this tax if the following requirements are satisfied: (1) the private foundation acquires the business under a will or testamentary trust and owns 100% of the interests in the business at all times in the relevant tax year; (2) the business distributes an amount equal to its net operating income to the private foundation within 120 days of the close of the tax year; and (3) the business and private foundation are independently operated. The prior version of the Senate bill had a similar provision, but it was removed in the final Senate bill.

[1] (100% – 70%) * 35% = 10.5%.

[2] (100% – 50%) * 20% = 10%.

[3] For tax years beginning after December 31, 2017 and before January 1, 2019, the effective rate would be 21.875% ([100% – 37.5%] * 35% = 21.875%).

[4] Under both the House and Senate bills, royalty income received by a CFC from third parties would continue to be treated as "active" non-Subpart F income—so long as the CFC adds substantial value to the underlying intangible property and is regularly engaged in the development of similar intangibles through the activities of its office, staff, or employees located in a foreign country (*see* Treas. Reg. § 1.954-2(d)(1)(i))—and would therefore be currently taxable at a reduced 10% rate under the House bill's "foreign high return" provision and under the Senate bill's GILTI tax. Therefore, under both bills, U.S. multinationals may still prefer to have their CFCs hire employees abroad to develop intangibles for sale or license to third parties outside of the United States to achieve the 10% rate on foreign high returns (rather than develop the intangibles in the United States and be taxed at either the 20% general corporate rate under the House bill or the 12.5% FDII rate under the Senate bill).

[5] 148 T.C. No. 8 (Mar. 23, 2017).

[6] 149 T.C. No. 3 (July 13, 2017) (holding that a foreign partner's sale of a partnership engaged in a U.S. trade or business generated solely foreign-source gain). The JCT description of the Senate bill refers to this decision specifically.

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