Tax Insights
from Washington National Tax Services

Congress gives final approval to tax reform conference committee agreement

December 20, 2017

In brief

Congress on December 20 gave final approval to the House and Senate conference committee agreement on tax reform legislation (HR 1) that would lower business and individual tax rates, modernize US international tax rules, and provide the most significant overhaul of the US tax code in more than 30 years.

The final conference committee agreement for HR 1 (the 'Conference Agreement' or the 'Agreement') would lower permanently the US federal corporate income tax rate from 35 percent to 21 percent. The Conference Agreement also would temporarily reduce the current 39.6-percent top individual income tax rate to 37 percent and revise other individual income tax rates and brackets. Both the new corporate tax rate and revised individual tax rates would be effective for tax years beginning after December 31, 2017. The Agreement would repeal the corporate alternative minimum tax (AMT), while retaining a modified individual AMT with higher exemption amounts and phase-out thresholds.

The Conference Agreement would provide the most significant overhaul of US international tax rules in more than 50 years by moving the United States from a 'worldwide' system to a 100-percent dividend exemption 'territorial' system. As part of this change, the Agreement includes two minimum taxes aimed at safeguarding the US tax base from erosion, along with other international tax provisions.

The Agreement includes a broad range of tax reform proposals affecting businesses and individuals, including a new 20-percent deduction for certain pass-through business income. In addition, the Agreement repeals or modifies many current-law tax provisions to offset part of the cost of the proposed tax reforms. The Joint Committee on Taxation (JCT) staff have estimated that the net revenue effect of HR 1 will be to increase the on-budget federal deficit by $1.456 trillion over 10 years.

As discussed below, it is unclear whether President Trump will sign the legislation into law before the end of this year, or if the signing might be delayed until January 2018.

In detail

Below is a general overview of select business and individual tax provisions in the Conference Agreement, along with links to the final statutory text, the Conference Committee report, and revenue estimates released by the JCT staff. For a brief summary of the Conference Agreement, see our December 17 PwC Insight.

The House on December 20 passed the bill by a vote of 224 to 201, with only Republicans voting yes and 12 Republicans voting no along with House Democrats. The December 20 House action was a repeat of an initial December 19 House vote in which the bill was passed by a similar margin. The second House vote was required because the Senate parliamentarian ruled that three items in the House-passed bill violated Senate budget reconciliations, as discussed below. After the three items were struck, the Senate late on December 19 passed the revised bill by a party-line vote of 51 to 48, with Senator John McCain (R-AZ) missing the vote due to illness. Now that identical versions of HR 1 have been passed by Congress, the legislation will be sent to the White House for presidential action.

The three items that were struck by the Senate parliamentarian related to a proposed change to Section 529 education savings plans, a new excise tax on the endowment funds of certain private colleges and universities, and the short title of HR 1, the 'Tax Cuts and Jobs Act.' These revisions were made after Senate Democrats raised a procedural objection that the provisions violated Senate budget reconciliation rules named after former Senator Robert Byrd (D-WV) that require measures to have a more than de minimis fiscal effect on the federal budget. See below for more details on the Byrd rule changes to the Section 529 and endowment fund provisions.

HR 1 is proposed generally to be effective for tax years beginning after 2017. Certain provisions have separate effective dates, while others are effective after the date of enactment and some are effective for tax years beginning after 2016. The bill includes some temporary measures and provisions that change in future years, along with transition rules for certain provisions. As discussed below, the legislation would sunset nearly all individual provisions (including pass-through business tax relief provisions and certain other business provisions) after 2025, in order to comply with a Senate budget reconciliation rule that allows a 60-vote procedural point of order against any legislation increasing federal deficits in future decades.

White House officials have stated that President Trump wants to sign HR 1 into law before the end of this year. The actual signing could be delayed until January 2018 because the projected increases in federal budget deficits could trigger automatic cuts to various federal spending programs including Medicare under a 2010 'pay-as-you-go' (PAYGO') statute. Congress later this week may waive the PAYGO requirement for HR 1 as part of a temporary funding bill that the House and Senate are considering to avoid a partial shutdown of the federal government when a temporary funding bill expires on December 22. If the PAYGO requirement is not waived this week, President Trump could sign the legislation in January 2018 and Congress would have additional time to resolve the PAYGO issue next year before automatic spending reductions would be triggered in 2019. Even if the PAYGO requirement is not waived this week it remains possible the President will choose to sign the legislation anyway on the presumption that Congress will address the automatic spending cuts when they return in January.

Observation: House Ways and Means Committee Chairman Kevin Brady (R-TX) has announced that the House may address certain temporary healthcare-related tax provisions as part of the temporary FY 2018 funding bill. Senate Finance Committee Chairman Orrin Hatch (R-UT) has proposed to extend a broader number of temporary business and individual tax provisions, including certain renewable energy tax provisions.

Income tax accounting considerations

In general ASC 740, *Accounting for Income Taxes*, requires the effects of changes in tax laws or rates to be recognized in the period in which the law is enacted regardless of the effective date. For US federal tax purposes, the enactment date most often is the date the President signs the bill into law. In the period of enactment, critical analysis of the resulting changes in US tax law will be needed to determine the appropriate financial statement effects.

The bill proposes significant changes, as discussed below, that, upon enactment, will have pervasive financial reporting implications, both in the period of enactment and on a prospective basis. For example, US deferred taxes will need to be remeasured as a result of the reduced corporate income tax rate. For companies with foreign operations, mandatory taxation of deferred foreign income, as well as various provisions intended to prevent erosion of the US tax base, may impact measurement of deferred taxes and taxes payable in the period of enactment. Other changes, such as

elimination or limitation of certain deductions, will impact both current and deferred taxes on a prospective basis. Changes in enacted tax law also will require the reassessment of realizability of deferred tax assets.

Companies will need to carefully evaluate the impact that the changes will have on their existing financial statement positions, assertions, and disclosures, in order to appropriately account for changes in the period of enactment. For many companies, this assessment will be complex and will require significant effort.

Business tax provisions

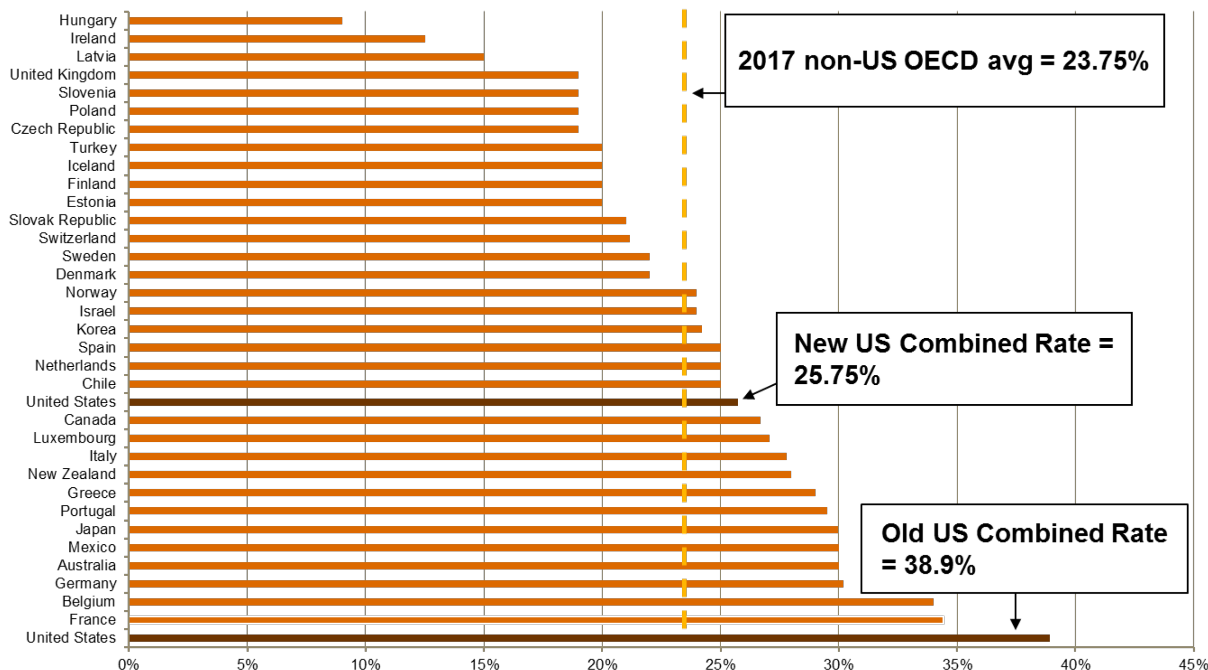
Corporate rate reduction

Under the Conference Agreement, the current 35-percent top corporate rate would be reduced permanently to 21 percent for tax years beginning after 2017. Both the House and Senate had previously approved reducing the US corporate rate to 20 percent, but the Senate bill would have delayed the corporate rate reduction by one year later than the House version, to tax years beginning after 2018.

Observation: Lowering the US corporate tax rate from 35 percent to 21 percent will be a historic achievement since the United States currently has the highest corporate tax rate among advanced economies. The US corporate tax rate, combined with average state and local corporate rates, currently is 38.9 percent. The combined US corporate rate will drop to 25.75 percent as a result of the legislation. This rate still will be two percentage points higher than the 23.75 percent average rate for all OECD nations, but would be lower than all other G-7 countries except the United Kingdom. See chart below.

Observation: Fiscal-year corporations will need to consider present-law Section 15(a), which requires taxpayers to perform prorated tax liability computations if a change in tax rate goes into effect during the taxpayer's tax year (other than on the first day of the taxpayer's tax year). Section 15(c) provides that if the tax rate changes for tax years 'beginning after' or 'ending after' a certain date, the following date is considered the effective date of the change. In the case of the Conference Agreement, the effective date of the rate reduction would be January 1, 2018. Therefore, to the degree Section 15 is applicable, fiscal-year taxpayers would have a prorated tax rate for the

New US federal statutory corporate tax rate (21% federal rate plus state average) closer to OECD average



tax year that includes the effective date of a rate change. In other words, under the Conference Agreement, a June 30, 2018 year-end (FY18) taxpayer would have six months of its FY18 taxable income subject to the present-law 35-percent corporate tax rate and six months of its FY18 taxable income subject to the reduced 21-percent corporate rate, resulting in an FY blended rate of approximately 28 percent.

Normalization rules for regulated utilities

The Conference Agreement adopts the House and Senate bill provisions and would provide for the normalization of a regulated utility's excess deferred income taxes (the difference between the utility's deferred taxes at the present-law 35 percent US corporate rate and the proposed 21-percent rate), similar to what was provided by section 203(e) of the Tax Reform Act of 1986, effective for tax years after 2017.

Observation: Normalization of excess deferred income taxes generally provides regulated utilities the opportunity to reduce rates charged to customers over the book life of the property, thus avoiding sharp fluctuations in rates charged to customers as a result of the tax rate change.

The Conference Agreement would expand the penalty for violating the normalization provisions by indicating that the taxpayer (a) must increase its tax for the year by the amount by which it reduces its excess tax reserve more rapidly than permitted and (b) would be denied the use of accelerated depreciation.

Corporate alternative minimum tax

The corporate alternative minimum tax (AMT) would be repealed under the Conference Agreement, effective for tax years beginning after 2017.

Taxpayers with AMT credit carryforwards could claim a refund of 50 percent of the remaining credits (to the extent the credits exceed regular tax for the year) in tax years beginning in 2018, 2019, and 2020. For any remaining AMT credit carryforwards after 2020, taxpayers could claim a refund for all such credits in the tax year beginning in 2021.

Observation: Under current law, a taxpayer has the ability to capitalize research and experimental (R&E) expenditures and amortize them over 10 years with a Section 59(e) election. The repeal of corporate AMT does not appear to modify Section 59(e), so taxpayers still would have the option of making a Section 59(e) election for tax years beginning before 2022. See below for a discussion of changes to the current deductibility of R&E expenditures for tax years beginning after 2021.

Full expensing of certain property

The Conference Agreement would amend Section 168(k)(1)(A) by striking '50 percent' and inserting '100 percent,' thus allowing taxpayers to expense immediately the entire cost of certain depreciable assets acquired and placed in service after September 27, 2017 and before January 1, 2023 (with an additional year for certain aircraft and longer production period property). For qualified property placed in service in calendar years 2023, 2024, 2025, and 2026 (2024, 2025, 2026, and 2027 for certain aircraft and longer production period property), the applicable percentage is reduced to 80 percent, 60 percent, 40 percent, and 20 percent, respectively .

In the case of qualified property acquired before September 28, 2017, and placed in service after September 27, 2017, certain phase-down percentages under current law will be applicable.

The Conference Agreement would make several notable modifications to the definition of 'qualified property' under Section 168(k)(2). First, it would expand the definition of qualified property by repealing the requirement that the original use of the property begin with the taxpayer. As a result, as long as such used property had not been used by the taxpayer at any time prior to the acquisition and meets the requirements of paragraphs (2)(A), (2)(B), (2)(C), and (3) of Section 179(d), it generally should be considered qualified property under Section 168(k) and eligible for immediate expensing. Second, the term 'qualified property' would not include, among other items, any property used in the trade or business of certain regulated public utilities as defined in Section 163(j)(7)(A)(iv). Additionally, the definition of 'qualified property' would be expanded to include qualified film, television, and live theatrical productions.

Observation: For taxpayers that do not wish to avail themselves of the immediate expensing provision, the ability to elect out of Section 168(k) would continue to exist. In addition, the Conference Agreement provides for an election to continue to use 50-percent bonus depreciation for qualified property acquired and placed in service after September 27, 2017, for the first tax year ending after September 27, 2017.

Observation: Since many states already decouple from or modify Section 168(k), continued nonconformity is expected in this area. Given the potential magnitude of the cost to states of conforming to Section 168(k), additional states may enact legislation to decouple from the provision. Nonconformity raises many state issues, including the inability of taxpayers to elect 50-percent bonus in lieu of 100-percent bonus for state

purposes, federal and state basis discrepancies, modifications required in computing state taxable income, and the financial statement implications associated with the potential book-to-tax differences from a state income tax perspective. Taxpayers should examine how states conform to or decouple from other provisions under Section 168, such as shortened recovery periods and full expensing for used property.

Recovery periods for real property

The Conference Agreement would eliminate the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and would provide a general 15-year MACRS recovery period for qualified improvement property and a 20-year alternative depreciation system (ADS) recovery period for such property. The Conference Agreement also would shorten the ADS recovery period for residential rental property from 40 years to 30 years. Finally, the Conference Agreement would require a real property trade or business electing out of the limitation on the deduction for interest to use ADS to depreciate its nonresidential real property, residential rental property, and qualified improvement property. These modifications would be effective for property placed in service after 2017.

Amortization of research and experimental expenditures

For tax years beginning after 2021, the Conference Agreement would repeal expensing of R&E expenditures, including software development costs, under Section 174 and require such expenditures to be capitalized and amortized over a five-year period, beginning with the midpoint of the tax year in which the specified R&E expenditures were paid or incurred. However, R&E expenditures that are attributable to research that is conducted outside the United States would be capitalized and amortized over a period of 15 years.

Observation: Treating software development costs as R&E expenditures for purposes of Section 174 would effectively revoke Rev. Proc. 2000-50 for tax years beginning after 2021. Under Rev. Proc. 2000-50, taxpayers may currently expense certain software development costs.

Net operating losses

Current law generally permits a taxpayer to carry back a net operating loss (NOL) two years and carry forward an NOL 20 years to offset taxable income in such years. Effective for losses arising in tax years beginning after 2017, the Conference Agreement would limit a taxpayer's ability to utilize its NOL deduction to 80 percent of taxable income (determined without regard to the deduction). The bill generally would eliminate the carryback of all NOLs arising in a tax year ending after 2017 and instead would permit all such NOLs to be carried forward indefinitely.

The Conference Agreement would eliminate the special carryback rules for ‘specified liability losses’ and casualty and disaster losses.

Observation: Most state NOL rules differ from federal NOL rules, with a few exceptions (e.g., Delaware, Missouri, Virginia). States that conform to federal NOL provisions generally, and carryforward periods in particular, may need to address the ramifications of the Conference Agreement.

Like-kind exchanges

Under current law, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a ‘like kind’ that is held for productive use in a trade or business or for investment. In a qualifying like-kind exchange, the basis in the new property equals the taxpayer’s adjusted basis in the exchanged property, thus deferring any gain inherent in the exchanged property. The Conference Agreement would limit the applicability of the gain deferral rules to only like-kind exchanges of real property, effective for exchanges completed after December 31, 2017.

A transition rule would allow for like-kind exchanges of personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired replacement property on or before December 31, 2017.

Observation: Taxpayers should consider state conformity matters to the extent individual states do not follow federal tax law.

Section 179

The Conference Agreement would increase the Section 179 dollar limitation to $1 million from $500,000, while increasing the cost of property subject to the phase-out to $2.5 million from $2 million for property placed in service in tax years beginning after 2017. The new dollar limitations would be indexed for inflation for tax years beginning after 2018. The Conference Agreement also expands the definition of Section 179 property to include additional types of property.

Interest expense

The Conference Agreement generally follows the Senate bill’s approach to limiting the deduction for business interest to the sum of business interest income and 30 percent of the ‘adjusted taxable income’ of the taxpayer for the taxable year, plus floor plan financing interest of the taxpayer for the taxable year, and allowing any disallowed business

interest to be carried forward indefinitely, for tax years beginning after 2017. However, for tax years beginning after December 31, 2017 and before January 1, 2022, the Agreement would 'add back' depreciation and amortization. The Agreement also follows the House bill in exempting from the limitation taxpayers with average gross receipts for the three-taxable-year period ending with the prior taxable year that do not exceed $25 million.

The Agreement drops a separate proposal (versions of which were in both the House and Senate bills) to impose a new Section 163(n) provision that would have limited the deductibility of certain interest expense of taxpayers that are members of a worldwide group based on the leverage of the domestic group compared to the worldwide group.

Observation: The Conference Agreement would provide that any disallowed business interest carryforwards are an item taken into account for transactions described in Section 381(a) (generally, tax-free liquidations and asset reorganizations) and would treat disallowed business interest carryforwards as a 'pre-change loss' subject to limitation under Section 382.

Observation: For pass-through entities, this interest limitation is determined at the entity level. There is some limited ability for the partners to use their share of the entity's attributes when the partners are determining their own interest limitation under this provision.

***Observation*:** States with rolling conformity or that start with federal taxable income would automatically conform to the new Section 163(j) limitation. Even if a state generally conforms to the disallowed interest carryover provisions, it may alter the carryover period similar to its treatment of NOL carryovers. A state that conforms to the carryover provisions would need to enact rules to determine whether the carryover would be applied on a pre- or post-apportionment basis.

Contributions to capital

Under present-law Section 118, the gross income of a corporation generally does not include contributions to its capital. The Conference Agreement would provide that 'contributions to capital' do not include (i) any contributions in aid of construction or any other contribution as a customer or potential customer, and (ii) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder in its capacity as such). The amendments to Section 118 generally would apply to contributions made after the date of enactment of the Conference Agreement.

Dividends received deduction

The bill would reduce the 70-percent dividends received deduction (DRD) to 50 percent and the 80- percent DRD to 65 percent, effective for tax years beginning after 2017.

Observation: The change in DRD rates would leave the effective tax rate on dividends received from less than 20 percent-owned corporations unchanged (i.e., 10.5 percent), but would slightly increase the effective rate on dividends received from 20 percent-owned corporations (i.e., 7.35 percent under the Conference Agreement versus 7 percent under current law).

Business credits

Like the House and Senate bills, the Conference Agreement would retain the research credit (but see discussion above of modifications after 2021 for capitalization and amortization of research expenditures) and the low-income housing tax credit.

The so-called 'orphan drug' tax credit would be reduced to 25 percent of the qualified clinical testing expenses for amounts paid or incurred in tax years beginning after December 31, 2017.

The 10-percent rehabilitation credit for pre-1936 buildings would be repealed. The 20-percent rehabilitation credit with respect to a certified historic structure would be retained in a modified form. These changes generally would apply to amounts paid or incurred after December 31, 2017.

The Conference Agreement would repeal certain other business tax credits.

The Agreement drops House proposals to repeal the Work Opportunity Tax Credit and New Markets Tax Credits.

The Conference Agreement also would leave unchanged certain energy tax credits prevalent in the power and utility industry, most notably the Section 45 Production Tax Credit (PTC) and the Section 48 Investment Tax Credit (ITC).

New employer credit for paid family and medical leave

The Conference Agreement would allow eligible employers in 2018 and 2019 to claim a general business credit up to 12.5 percent of wages for qualifying employees who are on family and medical leave, in addition to 0.25 percent (capped at 25 percent) for each percentage point that family and medical leave pay exceeds 50 percent of the employee's regular wages. The maximum amount of leave that may be taken into account for these purposes would be 12 weeks.

To qualify as an eligible employer, the taxpayer must have a written policy that (a) allows qualifying full-time employees at least two weeks of annual paid family and medical leave (not including leave paid by a State or

local government), and (b) allows non-full time employees a commensurate amount of leave on a pro rata basis. Vacation or personal leave does not constitute family and medical leave for these purposes. A 'qualifying employee' is an employee under the Fair Labor Standards Act who has been employed by the employer for at least one year and who, for the preceding year, had compensation of 60 percent or less of the compensation threshold for highly compensated employees ($120,000 for 2017 under Section 414(g)(1)). Employers would be able to either deduct the wages or claim the credit in 2018 and 2019.

Section 199 domestic manufacturing deduction

Under current law, a taxpayer may claim a deduction under Section 199 for certain qualified production activities performed in whole or in significant part within the United States, subject to a W-2 wage limitation. The Conference Agreement would repeal Section 199 for tax years beginning after 2017.

Observation: The Agreement does not include a provision in the House bill that would have retroactively extended Section 199 for domestic gross receipts from Puerto Rico for tax years beginning after December 31, 2016 and before January 1, 2018.

Deductions for entertainment expenses and meals

Currently, a taxpayer may deduct 50 percent of entertainment, amusement, or recreation expenses directly related to or associated with the active conduct of its trade or business or a facility used in connection with such activity under Sections 274(a)(1) and (n)(1). For amounts paid or incurred after December 31, 2017, the Conference Agreement would eliminate the deduction for the following expenses: entertainment, amusement, or recreation expenses; membership dues for clubs; and facilities used in connection with these items.

There also are several key changes to current deductions for employee meals, generally applicable for amounts paid or incurred after December 31, 2017. Presently, taxpayers may deduct up to 50 percent of meal expenses that are provided for the convenience of the employer under Section 119, and deduct all expenses related to employer-operating eating facilities that are a de minimis fringe benefit if certain other requirements are met. For tax years 2018 through 2025, the 50-percent limitation would continue to apply to meal expenses provided for the convenience of the employer and would be extended to employer-operated eating facilities that are de minimis. The wage exclusions for these benefits would not be impacted for meals provided to employees for the convenience of the employer or via a de minimis employer-operated eating facility, and therefore such benefits would remain excluded from employee wages. This provision is subject to sunset after 2025, as discussed below.

Executive compensation

Taxpayers currently may deduct only up to $1 million of compensation paid to a 'covered employee' of a publicly traded corporation under Section 162(m). The Conference Agreement would eliminate the current-law exception to the deduction limitation for performance-based compensation and commissions. Contributions to qualified plans and certain amounts otherwise excluded from an employee's wages would not be included in the $1 million limitation. Under the Conference Agreement, the definition of 'covered employee' would be expanded to include the chief financial officer (CFO) in addition to the chief executive officer (CEO) and three named executive officers whose compensation is reported in the corporation's annual proxy report. Covered employees for purposes of the deduction limitation for future years would include any person who was a covered employee for tax years beginning after December 31, 2016. Finally, the deduction limitation would be extended to corporations that are an issuer under Section 3 of the Securities Exchange Act of 1934 (Act) that had a class of securities registered under Section 12 of the Act or are required to file reports under Section 15(d) of the Act.

The expansion of the deduction limitation would be effective for tax years beginning after December 31, 2017, subject to a Conference Agreement transition rule. The Agreement's modifications to the deduction limitation would not apply to remuneration paid pursuant to a written binding contract in effect on November 2, 2017 and that was not materially modified on or after that date.

Observation*:* Publicly traded companies will need to revisit executive compensation packages for the top five covered employees and review existing agreements to assess whether the transition rule applies.

Equity compensation

The Conference Agreement would allow 'qualified employees,' not including certain top executives, to elect to defer income recognition for up to five years for stock of a privately held corporation received upon the exercise of nonqualified stock options or upon settlement of restricted stock units (RSUs). The election must be made no later than 30 days after the vesting date. An employer has federal income tax withholding and Form W-2 reporting obligations following the deferral period. There are a number of considerations with respect to

implementing the election, including written plan requirements, identification of eligible employees, employee notice, participation levels, whether the corporation purchased any of its outstanding stock in the preceding year, FICA tax timing, and coordination with statutory stock options.

Other general business provisions

The Conference Agreement drops a House proposal to repeal Section 1235 rules treating the gain or loss from a sale or exchange of patents as a capital asset. Certain self-created property -- self-created patents, inventions, models, or designs (whether or not patented), or secret formulas or processes -- no longer would be considered capital assets, effective for dispositions of such property after 2017.

Section 162(e) would be modified to disallow deductions for lobbying activities with respect to legislation before local government bodies, including Indian tribal governments. The provision would be effective for amounts paid or incurred on or after the date of the enactment of the Conference Agreement.

For amounts paid or incurred on or after the enactment date of the Conference Agreement, all payments to a government or governmental entity in relation to the violation of any law would be non-deductible, unless such payments clearly reflect amounts paid for restitution or to come into compliance with the law and are identified as such in the underlying agreement. Additional reporting requirements by the government agency would be required with respect to certain fines, penalties, and other amounts. No deduction would be allowed for any settlement or payment related to sexual harassment or abuse if subject to a nondisclosure agreement, effective for amounts paid or incurred after the date of enactment.

Insurance

The Agreement would retain modified versions of several proposals affecting the tax treatment of insurance companies, including proposals dealing with the computation of both life and nonlife insurance reserves, the capitalization of certain policy acquisition expenses, and proration regimes that limit the benefit insurance companies receive from tax-exempt interest and DRD. The Agreement conforms the treatment of life insurance company NOLs to the treatment of NOLs of other corporate taxpayers, but retains current law for NOLs of non-life companies. The Agreement drops a House proposal to impose an eight-percent surtax on life insurance company taxable income that had been inserted as a placeholder.

Banking

The Agreement would retain the limitation in the House and Senate bills on deductions for Federal Deposit Insurance Corporation (FDIC) premiums. The Agreement would phase out deductions for any FDIC premiums paid or incurred by financial institution groups with assets between $10 billion and $50 billion, effective for tax years beginning after 2017.

Tax-exempt bonds

The Conference Agreement drops a House proposal to repeal the tax-exempt interest exclusion for qualified private activity bonds. The Agreement retains a provision in the House and Senate bills to repeal the tax-exempt interest exclusion for advance refunding bonds, effective for advance refunding bonds issued after December 31, 2017. The Agreement includes other provisions affecting tax-exempt bonds.

Excise taxes

The Conference Agreement amends Section 4261 to provide that payments made after the date of enactment by aircraft owners to aircraft management companies for certain fees and expenses related to maintenance and operation of the owner's aircraft are not subject to federal excise tax on transportation of persons or property by air. The new provision, which treats certain lessees as owners, exempts from tax payments that historically may have been part of monthly management fees and the per-flight-hour fees, but requires that the expense be related to the aircraft owner's own aircraft.

Observation: This change resolves a controversy between the IRS and aircraft owners/management companies by legislating what taxpayers and collectors had considered to be transportation not subject to air transportation excise tax, while the IRS had taken the opposing view.

The Agreement also adopts a number of temporary provisions from the Senate bill related to the taxation of beer, wine (including mead and sparkling), and distilled spirits. Many of the provisions would reduce rates of tax on these products; others would provide reduced regulatory standards for these products. For example, many of the provisions amend the eligibility for and assignability of credits, alcohol content, etc. These provisions generally apply after December 31, 2017 and are set to expire at the end of 2019.

International tax provisions

The Conference Agreement generally would follow the Senate bill's approach, with some modifications, to implementing a territorial tax system by providing a 100-percent dividends received deduction (DRD) for certain qualified foreign-source dividends

received by US corporations from foreign subsidiaries, effective for distributions after 2017. The Agreement also generally adopts the Senate bill's provisions relating to the 'toll charge' on the undistributed earnings and profits (E&P) of US-owned foreign corporations, as well as the inclusion for 'global intangible low-taxed income' (GILTI), the deduction for 'foreign derived intangible income' (FDII), and the 'base erosion and anti-avoidance tax' (BEAT), with certain modifications. Although the Agreement adopts a number of other proposals set forth in the Senate bill, the Conference Agreement drops certain other international provisions from the final legislation (highlighted below).

Territorial tax

The Agreement would enact new Section 245A, which would provide a 100-percent DRD for the foreign-source portion of dividends received by a US corporation from foreign corporations with respect to which it is a US corporate shareholder. The foreign-source portion of dividends from such 'specified 10-percent owned foreign corporations' would include only the portion of undistributed E&P that is not attributable to ECI or dividends from an 80-percent owned domestic corporation, determined on a pooling basis. In addition, the Conference Agreement would follow the Senate bill and require that, in order to qualify for the DRD, a US corporate shareholder must own the stock of the distributing specified 10-percent owned foreign corporation for more than 365 days during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend.

The Conference Agreement, similar to the Senate bill, would not allow a DRD for any dividend received that is a hybrid dividend --i.e., an amount received from a controlled foreign corporation (CFC) for which a deduction would be allowed under Section 245A and for which the specified 10-percent owned foreign corporation received a deduction (or other tax benefit) from taxes imposed by a foreign country. Unlike the Senate bill, however, the Conference Agreement does not include the proposed amendment to Section 864(e)(3), which would have clarified that assets generating the tax-exempt portion of a dividend (including Section 245A) are not taken into account in allocating and apportioning deductible expenses.

The provision would apply to distributions made (and, for purposes of determining a taxpayer's foreign tax credit (FTC) limitation under Section 904, deductions with respect to taxable years ending) after 2017.

Observation: While domestic C corporations will be able to exclude income distributions from certain foreign subsidiaries, S corporations, RICs, and REITs will continue to include these distributions in income. Section 1363(b) requires an S corporation to compute its income in the same manner as an individual. Section 857(b)(2)(A) provides that REITs are not eligible for the DRD. Accordingly, S corporations and REITs cannot avail themselves of the new DRD.

'Deemed repatriation' toll charge

As part of a move to a territorial system, the Conference Agreement amends Section 965 to impose a toll charge on a US shareholder's pro rata share of certain foreign subsidiaries' previously untaxed foreign earnings (determined as of November 2, 2017 or December 31, 2017, whichever is higher). Generally, the post-1986 E&P of a CFC or a foreign corporation that is at least 10-percent owned by a US corporation will be within the scope of the toll charge. The US shareholder's toll charge inclusion amount is treated as additional subpart F income, which may be reduced by such US shareholder's pro rata share of the deficits of certain foreign subsidiaries, including foreign subsidiaries of other US shareholders within the same affiliated group.

A deduction is allowed on the toll charge amount to the extent necessary for the foreign E&P attributable to cash and other liquid assets to be taxed at an effective rate of 15.5 percent and all residual foreign E&P to be taxed at an effective rate of 8 percent. These rates are higher than the 14 percent and 7 percent rates proposed in the House bill, and the 14.49 percent and 7.49 percent rates proposed in the Senate bill.

Foreign tax credits for the portion of earnings subject to the toll charge tax would be available to offset the tax.

Observation: The Conference Agreement adopts the House bill's 'rate percentage equivalent' method, which would cause the foreign earnings subject to the toll charge to be taxed at the same effective rate regardless of the applicable statutory rate -- i.e., whether the 35-percent or 21-percent corporate tax rate, or a higher individual income tax rate, applies to the toll charge inclusion year. The Conference Report also adopts the coordination rule with respect to the Section 78 gross-up provisions of the House bill, which generally operates to keep the toll charge tax liability (taking into account allowable FTCs) uniform across different inclusion years.

The provision would permit a US shareholder to elect to pay the tax liability imposed under the toll charge tax over up to eight years.

The provision is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to US shareholders,

for the taxable years in which or with which such taxable years of the foreign corporation ends.

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

Global intangible low-taxed income

Following the Senate bill, the Conference Agreement would enact new Section 951A, which would require a US shareholder to include in income the 'global intangible low-taxed income' (GILTI) of its CFCs in a manner similar to subpart F income inclusions. Despite the name, this provision is not limited to low-taxed income. The full amount of GILTI would be includible in the US shareholder's income but reduced (as discussed below) through a 50-percent deduction.

The GILTI amount would be determined by calculating the aggregate 'net CFC tested income' of the US shareholder's CFCs reduced by the US shareholder's net deemed tangible income return in order to arrive at the GILTI amount. The Conference Agreement modifies the equation set forth in the Senate bill used to determine the shareholder's net deemed tangible income return for any taxable year. Under the Conference Agreement, that return is the excess (if any) of a routine return (10 percent) on the shareholder's aggregate pro rata share of qualified business asset investment (QBAI) of each of its CFCs over the amount of interest expense taken into account in determining the shareholder's net CFC tested income to the extent the interest income attributable to such expense is not taken into account in determining such shareholder's net CFC tested income. The GILTI amount then would be grossed up by 100 percent of the foreign taxes deemed paid or accrued with respect to the CFCs' gross tested income.

FTCs would be available for 80 percent of the foreign taxes imposed on the US shareholder's pro-rata share of the aggregate portion of its CFCs' tested income (but not any of its CFCs with a tested loss) included in GILTI (compared to the 100 percent of such taxes by which GILTI is grossed up). Furthermore, utilization of associated FTCs would be limited in two ways: (i) GILTI would be treated as a separate Section 904(d) category, such that FTCs deemed paid as a result of a GILTI inclusion can only reduce such an inclusion; and (ii) Section 904(c) would be amended to prevent US shareholders from carrying excess GILTI FTCs to other tax years.

Foreign oil and gas extraction income (as defined by Section 907(c)(1)) is specifically excluded from the GILTI provision.

The GILTI proposal would be effective for taxable years of foreign corporations beginning after December 31, 2017.

Observation: The Conference Agreement, unlike the Senate bill but similar to the House bill, reduces QBAI by interest expense deducted in computing net CFC tested income. However, interest expense is only taken into account under the Conference Agreement to the extent the associated interest income is not included in the US shareholder's GILTI -- e.g., interest expense attributable to interest paid between two wholly owned CFCs of the same US shareholder would not reduce QBAI, whereas interest expense paid to a wholly unrelated party would. Presumably the intent of this provision is to recognize the extent to which the routine return on debt-funded property accrues to the benefit of the creditor rather than the property owner.

Observation: The effect of the GILTI provision would be to subject a US shareholder to tax (at a reduced rate in the case of US corporations) on its CFCs' combined net income above a routine equity return on tangible depreciable business assets that is not otherwise subject to US tax or to foreign tax at a minimum rate or is not otherwise specifically excluded.

Deductions for foreign derived intangible income and global intangible low-taxed income

The Conference Agreement also adopts the Senate bill's proposed enactment of new Section 250 relating to deductions for 'foreign derived intangible income' (FDII) and GILTI. Section 250 would allow as a deduction an amount equal to 37.5 percent of a domestic corporation's FDII plus 50 percent of the GILTI amount included in gross income of the domestic corporation under new Section 951A. FDII is the portion of the net income of a domestic corporation, after taking into account

allocable deductions and a reduction for a routine return on QBAI, that is derived from sales or services provided, either directly or indirectly, to foreign unrelated persons located outside of the United States. For tax years beginning after December 31, 2025, the deduction allowed under this new provision would be reduced to 21.875 percent and 37.5 percent, respectively. If, in any taxable year, the domestic corporation's taxable income is less than the sum of its FDII and GILTI amounts, then the 37.5-percent FDII deduction and the 50-percent GILTI deduction would be reduced proportionally by the amount of the difference.

Observation: FDII is intended to represent a domestic corporation's income in excess of a routine return, determined on a formulaic basis, that is derived from serving foreign markets. When the deductions for FDII and GILTI are combined with the tax imposed under the GILTI provision, the effect is to subject domestic corporations to tax at a reduced rate on net income in excess of a routine return derived in connection with sales to, or services performed for, foreign customers, whether that income is earned by the corporation or its CFCs.

Observation: The Conference Agreement confirms that the 50-percent deduction relating to GILTI applies to the sum of the GILTI inclusion and the 100-percent gross up for FTCs. The Agreement also clarifies in the explanatory section that the FDII and GILTI deductions are not available for individuals, RICs, REITs, or S corporations.

Observation: Together, the GILTI tax and FDII deduction provide a 'carrot and stick' approach to taxing income from exploiting intangible property (IP). If a US-parented group holds its IP offshore, any returns from exploiting that IP will be taxed at a rate of at least 10.5 percent (and potentially higher considering foreign tax and the ability to receive a foreign tax credit for only 80 percent of foreign taxes). If the same group holds its IP in the United States, the 37.5-percent FDII deduction for sales and services income provided to unrelated foreign persons, effectively provides an ETR of at least 12.5 percent on returns to the same IP. The small rate differential (ignoring potential foreign tax) significantly decreases the advantage under current law of holding IP offshore.

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

Observation: With some limited exceptions, Section 1363(b) requires an S corporation to compute its income in the same manner as in the case of an individual. While GILTI is includible in the income of a US shareholder, the FDII and GILTI deductions are only allowed to domestic corporations. Accordingly, S corporation shareholders will not benefit from the DRD on certain qualified foreign-source dividends nor from the FDII and GILTI deductions.

Base erosion anti-avoidance tax

The Conference Agreement would adopt a base erosion anti-avoidance tax (BEAT) provision in the Senate bill with some modifications. The excise tax provision that was included in the House bill is not included in the Conference Agreement.

The Conference Agreement would target base erosion by imposing an additional corporate tax liability on corporations (other than a RIC, REIT, or S corporation) with average annual gross receipts for the three-year period ending with the preceding taxable year of at least $500 million and that make certain base-eroding payments to related foreign persons for the taxable year of three percent (two percent for certain banks and securities dealers) or more of all their deductible expenses, with certain exceptions.

The BEAT would be imposed if 10 percent -- five percent (or six percent for certain banks and securities dealers) for the 2018 calendar year -- of the modified taxable income (generally taxable income adding back any base-eroding tax benefit plus the base erosion percentage of the NOL deduction) exceeds the taxpayer's regular tax liability over certain allowable credits. For purposes of computing modified taxable income, any base-eroding tax benefit attributable to a base-eroding payment that has been withheld upon is not taken into account, except that if the rate of tax was reduced (e.g., by treaty), the exclusion would apply only in proportion to the reduction.

A base-eroding payment generally is any amount paid or accrued by the taxpayer to a related foreign person that is deductible, to acquire property subject to depreciation or amortization, or certain reinsurance payments. Additionally, a base erosion payment would include any amount paid or accrued by the taxpayer to a related foreign corporation which first became a surrogate foreign corporation after November 9, 2017 under the anti-inversion rules (or any foreign person that is a member of the same expanded affiliated group as the surrogate corporation). Cost of goods sold is not a deductible payment and would not be a base-erosion payment,

except when made to a surrogate foreign corporation (or a related foreign affiliate of the surrogate corporation).

The provision would be effective for amounts paid or accrued after December 31, 2017. In 2026 and thereafter, the BEAT would increase to 12.5 percent (13.5 percent for certain banks and securities dealers) and would not be offset by any credits.

Observation: Aspects of the bill raise questions about whether certain provisions are in conflict with and may override US tax treaties. This provision, which is restricted to payments made to related foreign parties, is an example of the tension with US tax treaty obligations. It may be viewed as violating the non-discrimination article of US tax treaties since it restricts tax benefits based on the nationality of the recipient of the payment.

Observation: Broadly, the Conference Agreement does not alter the arm's-length standard as reflected in US domestic law and relevant treaties, although it does alter the statutory language for the definition of intangibles and for the application of certain valuation methods in the context of intangible transfers (as discussed below). Regarding the related-party components of the BEAT and GILTI calculations, companies still will need to ensure compliance with the arm's-length standard; also, from a foreign perspective, companies must weigh forthcoming BEPS and OECD initiatives in the context of revisiting their operating models and capital structure. The move to a lower rate in the United States may invite the scrutiny of foreign jurisdictions to the extent changes are made to existing intercompany policies.

Changes to the definition of intangibles and valuation principles

The Conference Agreement, consistent with the Senate bill, would amend Section 936(h)(3)(B) to include in the definition of intangible property, for purposes of Sections 367 (relevant to outbound restructurings) and 482 (intercompany transfer pricing), workforce in place, goodwill, going concern value, and any other item of intangible value.

The Conference Agreement would also amend Sections 367 and 482 to codify certain valuation principles reflected in the current Section 482 regulations with respect to transfers of intangible property. Specifically, the Conference Agreement would authorize the IRS to apply the 'realistic alternatives' principle and to value transfers of multiple intangibles (or intangibles and services, for example) on an aggregate basis. However, the Conference Agreement tempers the above language by requiring that the application of these principles must still satisfy the best method rule under US regulations. These statutory changes would apply to transfers in taxable years beginning after December 31, 2017.

Observation: The expanded definition of intangibles and codification of the IRS's preferred valuation principles could particularly impact IRS scrutiny of transactions or restructurings involving high-value or hard-to-value intangibles, including those involving multiple interrelated elements (such as the implementation of a cost sharing arrangement). The Conference Agreement changes reflect for the most part provisions already incorporated in the current Section 367 and Section 482 regulations, but the IRS may be further encouraged in its efforts by the fact that these valuation principles coupled with an all-encompassing definition of intangibles will now be enshrined in statute. A potential issue arises to the extent the positions the IRS may take under the new statutory authority and intangible definition create tension with international standards such as the OECD Transfer Pricing Guidelines, which apply under the domestic law of many countries as well as under US income tax treaties.

Other international proposals

The Conference Agreement incorporates other international proposals, which include amendments that would:

- Modify Section 863(b) with respect to income, profits, and gain from the sale of inventory by sourcing such amounts entirely to the place of production rather than by reference to the location of production and sales
- Repeal Section 902 and clarify that FTCs would only be available under Section 960 to the extent foreign taxes are properly attributable to any item of income under Section 951(a)(1) that is included in a US shareholder's gross income
- Deny deductions relating to certain related-party amounts paid or accrued in hybrid transactions or with hybrid entities
- Treat a foreign partner's gain or loss from the sale or exchange of a partnership interest as effectively connected with a US trade or business to the extent the partner would have had effectively connected gain or loss if the partnership had sold all its assets in a taxable sale at fair market value and allocated the gain or loss to the foreign partner in the same manner as non-separately stated income and loss (i.e., generally the partner's distributive share)

- Modify current anti-deferral rules (e.g., broaden the stock attribution rules for determining CFC status; eliminate the requirement that a foreign corporation must be a CFC for 30 days in order for its US shareholders to have subpart F inclusions; and expand the definition of US shareholder to include a 10-percent value test)
- Modify the passive foreign investment company rules as applied to certain income derived by a qualifying insurance corporation.
- Repeal the treatment of foreign base company oil related income as a separate category of subpart F income, effective for tax years of foreign corporations beginning after December 31, 2017.

The Conference Agreement does not include in the final legislation certain international proposals previously included in the House and/or Senate bills. For example, the Conference Agreement would:

- Not make permanent the CFC 'look-through' rule
- Not exempt domestic corporations from Section 956 (i.e., Section 956 would continue to apply to domestic corporations)
- Not include the provision that would have temporarily incentivized the onshoring of IP by providing for the nontaxable transfer of IP from CFCs to US shareholders
- Not include an inflation adjustment for the de minimis exception for foreign base company income
- Not accelerate the effective date of the worldwide interest allocation rules.

Pass-through tax provisions

New deduction for qualified pass-through business income

The Conference Agreement generally adopts the Senate bill's approach to reducing taxes on certain qualified business income of an individual, effective for tax years beginning after December 31, 2017 and before January 1, 2026. The Agreement would provide a 20-percent deduction for qualified business income from a partnership, S corporation, or sole proprietorship (down from 23 percent in the Senate bill), but would achieve the same level of effective tax rate relief as the original Senate bill, because the 20-percent deduction combined with a top ordinary income tax rate of 37 percent would result in a top rate of 29.6 percent for such income in the absence of other limitations.

In general, qualified business income is the net amount of qualified items of income, gain, loss, and deduction with respect to any qualified trade or business of the taxpayer. Qualified items generally are items of income, gain, loss, and deduction effectively connected with the conduct of a qualified trade or business in the United States. Qualified business income does not include investment-type income (e.g., capital gains, dividends, and non-business interest) or reasonable compensation and guaranteed payments. A qualified trade or business generally is any business other than a 'specified service trade or business' (defined below) or the trade or business of performing services as an employee.

Under the Conference Agreement, in the case of an individual whose taxable income exceeds the relevant income thresholds noted below, the deduction of each qualified business's income is capped at the greater of (a) 50 percent of the individual's allocable share of W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the individual's allocable share of W-2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property (the 'W-2 wage limitation'). The W-2 wage limitation does not apply to qualified REIT dividends, cooperative dividends, and publicly traded partnership income, regardless of the individual recipient's taxable income.

Under the Conference Agreement, the W-2 wage limitation does not apply to an individual whose taxable income is less than $157,500 for a single filer ($315,000 for a joint filer). Above these thresholds, the W-2 wage limitation phases in over the next $50,000 of income ($100,000 for joint filers). The thresholds in the Conference Agreement were reduced from $250,000 and $500,000, respectively, in the Senate bill.

The Agreement defines 'specified service trade or business' as any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees. In addition, a specified trade or service business includes investing and investment management, trading, and dealing in securities, commodities, or partnership interests. The Agreement removes engineering and architecture services from the list of specified service businesses. The Agreement also provides that trusts and estates are eligible for the 20-percent deduction.

Observation: Future choice of entity decisions must factor in the changes to the corporate tax rate alongside a

business owner's (or owners') expected ability to claim this new pass-through business deduction. Among many considerations, a business owner must examine the nature of the business (service based, number of employees); the owners' desire or need to extract cash from the business; the services, if any, the owner will perform for the business; and the owners' expected taxable income. Consideration also should be given to whether multiple businesses held in the same entity could be separated to allow one to claim the deduction.

Applying this provision to the owners of existing pass-through entities will require additional compliance at both the entity and individual level. For example, the entity will need to report separately all of the items an owner will need to calculate the amount each owner may claim as a deduction. This means all of the qualified business income, the owner's applicable share of the business's W-2 wages, and the owner's applicable share of the qualified property's 'unadjusted basis' must be calculated for each entity each year due to the uncertainty surrounding the ultimate owner's ability to claim the deduction. Moreover, because the deductible amount is calculated separately for each trade or business, the W-2 wage amounts and basis amounts cannot be reported in the aggregate for entities with more than one trade or business.

Observation: The Conference Agreement clarifies that the 20-percent deduction is not allowed in computing adjusted gross income, but instead is allowed as a deduction reducing taxable income. The Conference Agreement also clarifies that the deduction is available to both non-itemizers and itemizers. Since many states adopt adjusted gross income as their starting point for determining the tax base for individuals, conformity issues can arise. Taxpayers are advised to consider the differing starting points for determining the state tax base.

Pass-through business losses

For taxable years beginning after December 31, 2017 and before January 1, 2026, business losses in excess of business income plus $500,000 (married filing a joint return) would not be deductible for the current tax year. Such losses would be carried forward and treated as part of the taxpayer's NOL carryforward in subsequent taxable years. This limitation would apply after the application of the passive loss rules. Business losses covered by this provision would include passthrough losses as well as sole proprietor and farm losses. In the case of partnership and S corporation losses, the limitation is applied at the partner or shareholder level.

Observation: This provision would limit the ability of taxpayers to use large business losses to offset other income in their returns (e.g., interest, dividends, capital gains). This limitation applies after the taxpayer has determined that the loss is non-passive under Section 469.

S corporation shareholder limitations

The Conference Agreement would modify the S corporation shareholder limitations by permitting non-resident aliens to be potential current beneficiaries of an electing small business trust, effective January 1, 2018. In addition, electing small business trusts would be permitted to claim charitable contribution deductions under rules applicable to individuals as opposed to those governing trusts, effective for tax years beginning after December 31, 2017.

Observation: While these two changes provide greater opportunity to elect S status and reduce the tax associated with S corporation income allocable to an electing small business trust, many of the other changes found in the Conference Agreement would significantly reduce the tax advantage of operating as an S corporation relative to a C corporation.

S corporation conversions to C corporation

As the tax benefits of S corporation status have been significantly reduced, the Conference Agreement would provide certain relief to taxpayers converting to C corporation status, effective on enactment. First, any Section 481(a) amount required to be taken into account by any eligible terminated S corporation would be taken into account ratably over the six-year period beginning with the year of change. An eligible terminated S corporation is any C corporation that (1) was an S corporation on the date of enactment, (2) revoked its S election on or after the date of enactment (but no more than two years after the date of enactment), and (3) had the same shareholders in identical ownership percentages on the date of enactment and on the date of revocation.

Under current law, cash distributions from a corporation that had terminated its S election could be treated as made from the accumulated adjustments account during the post-termination transition period and thus could be received tax-free to the extent of basis. The post-termination transition period is generally the period beginning on the day of the S termination event and ending on the later of the one-year anniversary of such termination or the due date for filing of the return for the last S corporation year. The Conference Agreement provides that cash distributions of an eligible terminated S corporation made after the post-

termination transition period would be sourced and treated as received proportionately from any remaining accumulated adjustments account and accumulated earnings and profits of the distributing corporation.

Observation: The post-termination transition period distribution rule only applies to distributions made to shareholders who were shareholding in the S corporation at the time of termination of S status. While there is a shareholder continuity test to qualify as an eligible terminated S Corporation, there is no shareholder continuity test for the sourcing rule to apply to cash distributions after the post-termination transition period. In addition, under current law, shareholders can elect to not have the post-termination transition period distribution rules apply. It appears that no such election is eligible for cash distributions following the post-termination transition period under the Conference Agreement.

Observation: It appears these provisions were added to lessen the burdens of converting from an S corporation to a C corporation. Taxpayers are advised to consider all consequences that might arise from the termination of an S election, including the termination of qualified subchapter S subsidiary elections and any potential gains or income that may be triggered as a result of the deemed transactions prescribed by Section 1361(b)(3)(C).

Partnership technical termination

For partnership tax years beginning after 2017, a partnership would be treated as continuing to exist (i.e., there would be no 'technical termination') even if more than 50 percent of the total capital and profits interests of such partnership were sold or exchanged.

Observation: For most partnerships, this provision would simplify their compliance as it eliminates the required short-period return when there has been a transfer of a majority interest. However, it will require greater diligence and negotiating for selling partners in M&A deals to control the return filing in the year they dispose of their interests. It also removes some flexibility partnerships had to eliminate accounting and other tax elections without IRS approval.

Gain or loss of foreign persons from disposition of interest in partnership with US trade or business

The Conference Agreement would adopt the Senate bill provision treating gain or loss from the sale or exchange of a partnership interest by a non-US person as income effectively connected with a US trade or business to the extent that the transferor would have had effectively connected gain or loss if the partnership had sold all of its assets for their fair market value on the date of the interest sale or exchange. Under the provision, a transferee must withhold 10 percent of the transferor's amount realized on the sale or exchange of a partnership interest unless the transferor certifies that it is not a nonresident alien or foreign corporation. The partnership must deduct and withhold from distributions to the transferee partner any amount that the transferee fails to withhold from the transferor.

The Conference Agreement changed the effective date for withholding, which under the Senate bill was retroactive to November 27, 2017. Under the Conference Agreement, withholding is required for sales or exchanges occurring after December 31, 2017. Nevertheless, the general provision, treating gain or loss on the sale of certain partnership interests as effectively connected with a US trade or business, still would be effective as of November 27, 2017. In addition, the conferees noted their intention to allow the IRS to provide guidance permitting a broker, as agent of the transferee, to deduct and withhold the required 10 percent.

Observation: This provision legislatively overturns the recent taxpayer victory in *Grecian Magnesite Mining v. Commissioner*, 149 T.C. 3 (2017).

Other partnership provisions

The Conference Agreement would adopt the following partnership provisions in the Senate bill:

- The provision modifying the definition of 'substantial built-in loss' under Section 743(d) to provide that a substantial built-in loss also exists if the transferee partner would be allocated a net loss in excess of $250,000 upon a hypothetical sale and liquidation of the partnership.
- The provision modifying Section 704(d) to apply the outside basis limitation to a partner's distributive share of charitable contributions and foreign tax credits. Currently, a partner may deduct its distributive share of the partnership's charitable contributions regardless of its tax basis in the partnership.

Carried interest

The Agreement would recharacterize certain gains with respect to an applicable partnership interest from long-term capital gains to short-term capital gains to the extent such gains relate to property with a holding period not greater than three years, effective for tax years beginning after December 31, 2017.

In general, an applicable partnership interest is a partnership interest transferred to or held by a taxpayer in connection with the performance of 'substantial services' by the taxpayer

in an 'applicable trade or business.' An applicable trade or business is generally the activity of raising or returning capital, and investing in or developing securities, commodities, real estate, or partnership interests. Excluded from the definition of 'applicable partnership interest' are partnership interests held by a corporation and certain capital interests in a partnership. Additionally, the Agreement provides that if a taxpayer holding an applicable partnership interest transfers such interest to a related person, then the taxpayer is required to recognize as short-term capital gain its share of long-term capital gain 'with respect to such interest attributable to' assets not held for more than three years.

Observation: The provision raises a number of questions. First, it does not state explicitly how it applies to the sale or exchange of the applicable partnership interest itself. Capital gain might be calculated (and the holding period measured) at the entity level. Alternatively, the related-party transfer rule seems to imply that the partnership should be viewed as an aggregate and that in that case it is the assets of the partnership and the partnership's holding period with respect to such assets that are relevant for purposes of the rule. Second, it is unclear how the provision applies to mixed profits and capital interests. The provision does not address the potential for an interest to qualify in part for the capital interest exception; a note in the Conference Committee report regarding the exception is not explicit on the point either, but does seem to suggest the intent that part of an interest could qualify for the exception even if another part does not. Third, the interaction between the provision and various provisions in the Code that may create long-term capital gain regardless of the holding period, e.g., Section 857 (REIT capital gain dividends) or Section 1256, is not specified. When considering these questions and others, it is notable that the provision grants Treasury the authority to issue regulations or other guidance to 'carry out the purposes' of the provision.

Observation: This provision generally would apply to general partners of private equity funds, hedge funds, real estate funds, and other investment partnerships (subject to the exceptions for capital interests and interests held by corporations), but does not recharacterize long-term capital gain with respect to assets with holding periods of greater than three years. As a result, some carried interest allocations to the general partners of funds would not be impacted by this provision; for example, private equity funds often hold investments for longer than three years, under which circumstance the related gains allocated to general partners would continue to be treated as long-term capital gains. Nonetheless, allocations from funds with shorter holding periods would be impacted, and even general partners of funds that typically have longer holding periods may be impacted at times, including in the event that positions have split holding periods some of which might be less than three years. Separately, asset managers who have fee waiver agreements should consider the impact this provision may have on the related allocations.

Accounting methods

Taxable year of inclusion

Under an accrual method of accounting, income is includible in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. In general, a taxpayer has a fixed right to receive income under Section 451 at the earlier of when such amount is due to, paid to, or earned by the taxpayer. As a result, income that is due or paid in advance of being earned (i.e., an advance payment) generally must be recognized at such time, unless an exception permits deferral or exclusion. In contrast, an amount not due or paid is not required to be recognized unless it is otherwise earned for tax purposes, regardless of whether the amount was recognized in the taxpayer's applicable financial statement (e.g., as an unbilled receivable).

The Conference Agreement would revise the rules with respect to the recognition of income and require accrual-method taxpayers subject to the all-events test for an item of gross income to recognize such income no later than the tax year in which such income is taken into account as revenue in an audited financial statement or another financial statement under rules specified by the Treasury Department. The Conference Agreement would provide exceptions for gross income attributable to mortgage servicing rights and items of gross income for which a special method of accounting is required (e.g., long-term contracts accounted for under Section 460).

The explanatory materials to the Conference Agreement state that this provision would not revise the rules associated with when an item is realized for Federal income tax purposes and, accordingly, does not require recognition in situations where the Federal income tax realization event has not yet occurred. For example, a recharacterization of a transaction from sale to lease, or vice versa, to conform to how the transaction is reported in a taxpayer's financial statement would not be required. Nor would the provision require the recognition of gain or loss from securities that are marked to market for financial reporting purposes if the gain or loss from such

investments is not realized for Federal income tax purposes until such time that the taxpayer sells or otherwise disposes of the security.

In addition, the Conference Agreement would codify the deferral provisions under Rev. Proc. 2004-34 for advance payments for goods and services only (with authority given to the Treasury Department to include additional items in the future). That is, a taxpayer that receives advance payments for goods or services during the taxable year may recognize such advance payment in gross income upon receipt, or to the extent such advance payment is not recognized in the taxpayer's audited financial statement (or other financial statement), may defer the recognition of such advance payment in gross income until the next succeeding taxable year. The explanatory materials to the Conference Agreement indicate that this proposal is intended to override the exception to the two-year (or longer) deferral for advance payments received for the sale of goods available to taxpayers under Treas. Reg. sec. 1.451-5.

Observation: The Conference Agreement would accelerate the recognition of revenue to the extent that it eliminates instances in which taxpayers may have been eligible to recognize revenue later than when recognized for financial statement purposes (e.g., unbilled receivables for services or licensed property where revenue is not earned for tax purposes) or were eligible to defer advance payments longer than the one-year deferral permitted under Rev. Proc. 2004-34. Furthermore, taxpayers that receive advance payments for items currently eligible for deferral under Rev. Proc. 2004-34 (e.g., software and intellectual property) will be required to recognize such advance payments in gross income upon receipt absent the Treasury Department providing additional items eligible for deferral.

The modifications to Section 451 apply to tax years beginning after 2017 (2018 for income from debt instruments having original issue discount (OID)). The application of these rules would be a change in method of accounting for purposes of Section 481. In general, any Section 481(a) adjustment resulting from the change in method of accounting would be taken into account under current IRS procedures, which is generally ratably over four tax years. In the case of income from a debt instrument having OID, the Conference Agreement would provide for a six-year spread period.

Observation: Taxpayers should consider state conformity matters to the extent individual states do not follow federal tax law.

The Conference Agreement includes several accounting method changes aimed at simplifying tax compliance for small businesses.

Cash method of accounting

Under current law, businesses structured as C corporations or partnerships with a C corporation partner may use the cash method of accounting only if their average annual gross receipts for the prior three tax years do not exceed $5 million for all prior tax years (including the prior tax years of any predecessor of the entity). The Conference Agreement would increase the $5 million threshold for corporations and partnerships with a C corporation partner to $25 million. Additionally, the requirement that such businesses satisfy the gross receipts requirement for all prior tax years would be repealed.

Accounting for inventories

The Conference Agreement would allow businesses, including those with inventories, to use the cash method of accounting if the average annual gross receipts for the prior three tax years does not exceed $25 million. If a taxpayer meets the gross receipts test, the provision would allow the taxpayer to account for inventories as either (1) non-incidental materials and supplies or (2) consistent with the method of accounting used in its financial statements or books and records.

Uniform capitalization

In general, taxpayers that produce real or tangible personal property, or acquire real or personal property to resell in the ordinary course of business, are subject to the uniform capitalization (UNICAP) rules requiring the capitalization of certain direct and indirect costs to the property. Under current law, a taxpayer is not subject to the UNICAP rules with respect to personal property acquired for resale if its average annual gross receipts for the prior three tax years does not exceed $10 million. No such exemption exists for taxpayers that produce real or tangible personal property or acquire real property. The Conference Agreement would provide an exemption from the UNICAP rules for all businesses with average annual gross receipts for the prior three tax years of $25 million or less.

Accounting for long-term contracts

Under current law, the taxable income attributable to a long-term contract generally must be determined under the percentage-of-completion method (PCM). An exception from this requirement is available for certain construction contracts expected to be completed within a two-year period from the contract commencement date if a taxpayer has average annual gross receipts for the prior three tax years of $10 million or less.

The Conference Agreement would increase the $10 million average annual gross receipts test to $25 million. A business that meets the increased average annual gross receipts test could use its overall method of accounting or any other permissible exempt contract method (e.g., completed contract method) for construction contracts expected to be completed within a two-year period from the contract commencement date.

All of the above small business provisions would be effective for tax years beginning after 2017. Further, the average annual gross receipts referenced in the small business provisions would be indexed for inflation for any tax year beginning after 2018.

Observation: As a result of the proposed increase to the average annual gross receipts threshold in these provisions, additional taxpayers may become eligible to use one or more of the small business provisions. Any change to one of these methods would constitute a voluntary change in method of accounting that generally would require the filing of a Form 3115, *Application for Change in Accounting Method*. A taxpayer's change in method of accounting for long-term contracts would be implemented on a cut-off basis and would only apply to eligible contracts entered into on or after the year of change. The accounting method change for all other small business provisions would be implemented with a Section 481(a) adjustment.

Individual provisions

The Conference Agreement would retain the current bracket structure of seven individual tax rates, but would lower the top rate to 37 percent and make additional modifications to the income levels for some brackets. Individuals would reach the top marginal bracket at taxable income of $500,000 (single) and $600,000 (married joint). Trusts reach the top tax bracket at $12,500 of taxable income.

Individual tax relief sunsets

Like the Senate bill, the Conference Agreement would sunset nearly all individual provisions (including pass-through business tax relief provisions) after 2025, in order to comply with a Senate budget reconciliation rule that allows a 60-vote procedural point of order against any legislation increasing federal deficits in future decades. Inflation indexing

The Agreement would adjust individual tax brackets and certain other individual provisions for inflation based on chained CPI (the chained CPI adjustment is not subject to sunset). Some individual provisions including the expanded child tax credit and $10,000 cap on deductions for state and local taxes noted below are not indexed for inflation.

Current Law (2018)			Conference Agreement		
Rate	Taxable income		Rate	Taxable income	
	Single	Married		Single	Married
10%	$0 to $9,525	$0 to $19,050	10%	$0 to $9,525	$0 to $19,050
15%	$9,526 to $38,700	$19,051 to $77,400	12%	$9,526 to $38,700	$19,051 to $77,400
25%	$38,701 to $93,700	$77,401 to $156,150	22%	$38,701 to $82,500	$77,401 to $165,000
28%	$93,701 to $195,450	$156,151 to $237,950	24%	$82,501 to $157,500	$165,001 to $315,000
33%	$195,451 to $424,950	$237,951 to $424,950	32%	$157,501 to $200,000	$315,001 to $400,000
35%	$424,951 to 426,700	$424,951—$480,050	35%	$200,001 to $500,000	$400,001 to $600,000
39.6%	$426,701 or more	$480,051 or more	37%	Over $500,000	Over $600,000

Standard deduction

The standard deduction for 2018 would be increased to $24,000 for joint filers, $12,000 for individual filers, and $18,000 for single filers with at least one qualifying child. Amounts would be adjusted for inflation for tax years beginning after 2018.

Personal exemptions

Personal exemptions ($4,150 in 2018 with phaseout starting at $320,000 of joint income) would be repealed after 2017. At the discretion of the Treasury, wage withholding rules may remain the same as under present law for 2018.

Mortgage interest

For any acquisition indebtedness incurred after December 14, 2017, interest would only be deductible for loan amounts not exceeding $750,000 (for married filing jointly). As under

current law, the acquisition debt limit applies in aggregate on up to two personal residences. Existing mortgages as of December 14, 2017 continue to be subject to the current $1,000,000 limitation. Under the Conference Agreement, a taxpayer who has entered into a binding written contract before December 15, 2017 to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, is considered to have incurred acquisition indebtedness prior to December 15, 2017 under this provision.

Interest no longer would be deductible on a home equity loan after 2017, unless the proceeds are used to substantially improve a home and therefore meet the definition of acquisition debt.

Unlike the House and Senate bills, the final Conference Agreement does not change the current rules for excluding the gain from qualifying sales of a principal residence.

Observation: More stringent mortgage interest deduction limits, as well as limitations on deductible real property taxes, could impact some real estate markets and home construction.

State and local tax deductions

The Conference Agreement would permit individual taxpayers to deduct for tax years beginning after 2017 up to $10,000 for any combination of state and local income taxes, property taxes, and sales taxes. Otherwise, an individual could deduct such taxes only if incurred in a trade or business or Section 212 activity.

Observation: With the pending limitation on the itemized deduction for state and local income taxes, many taxpayers had considered prepaying 2018 state and local taxes by December 31, 2017. The Conference Agreement contains a provision intended to eliminate the ability to deduct such income tax prepayments.

Other itemized deductions

The Agreement would eliminate the 'Pease' limitation on overall individual itemized deductions.

Like the Senate bill, the Agreement would reduce the threshold for deducting medical expenses from 10 percent to 7.5 percent for tax years beginning after December 31, 2016 and ending before January 1, 2019. The threshold applies for purposes of the AMT and the regular tax for the specified years.

Deductions for personal casualty losses would only be allowed if the loss was attributable to specially designated disasters.

The Agreement would repeal the deduction for alimony payments made by a payor spouse, effective for any divorce or separation instrument executed after the end of 2018, with a special rule for post-2018 modifications of a divorce or separation instrument executed before the end of 2018.

Deductions for miscellaneous itemized deductions subject to the two-percent floor (including tax preparation fees, investment expenses, and unreimbursed business expenses) would be repealed.

Observation: States vary widely in how they treat itemized deductions for individual taxpayers under their income tax laws. To the extent that state law conforms to federal deductions, the repeal of various itemized deductions proposed by the Conference Agreement could impact a taxpayer's state income tax liability.

Investment income

Like the House and Senate bills, the Conference Agreement retains present-law maximum rates on net capital gains and qualified dividends. The Agreement also leaves in effect the Affordable Care Act's 3.8-percent net investment income tax and the 0.9-percent additional Medicare tax that apply to higher-income individuals.

The Conference Agreement drops a Senate proposal to require recognition of gain for sale of securities on a first-in, first-out (FIFO) basis.

Charitable donations

The Conference Agreement would preserve the itemized deduction for charitable contributions, with certain modifications. The Agreement would increase from 50 percent to 60 percent the income limit for charitable contributions of cash to public charities; deny a charitable deduction for payments made in exchange for college athletic event seating rights; and repeal the substantiation exception for certain contributions reported by the donee organization.

Child credits

The Conference Agreement would increase the child tax credit from $1,000 under current law to $2,000 per child and increase the refundable portion of the credit to $1,400. At the same time, the Agreement drops the Senate proposal to increase the age limit for a qualifying child from under 17 to under 18 years old, so the age limit remains as under current law. The Agreement would provide a $500 nonrefundable credit for a qualifying dependent other than a qualifying child. The Agreement also would increase the phaseout threshold gross income levels for claiming the credit, to $400,000 from $110,000 (under current law) for joint filers and $200,000 from $75,000 (under current law) for all other filers. The

Senate bill included a phaseout at $500,000 for all filers.

Education

The Conference Agreement would modify Section 529 education savings plan rules to allow distributions of up to $10,000 annually for tuition expenses incurred in connection with enrollment or attendance of a student at a public, private, or religious elementary or secondary school. Unlike most other individual tax provisions, this specific provision does not include any sunset language.

Observation: A Conference Agreement provision that would have modified the definition of Section 529 qualifying education expenses to include certain homeschooling expenses was struck by the Senate parliamentarian as violating the Byrd rule, as discussed above.

If a student loan is discharged based on the death or total disability of a student, any income resulting from the discharge would be excluded from taxable income if the loan is discharged after 2017 and before 2026.

The Agreement also includes a provision dealing with rollovers of Section 529 contributions to qualified accounts to benefit disabled individuals, known as qualified ABLE programs.

The Agreement drops certain House proposals affecting higher education, including proposals to consolidate the American Opportunity Tax Credit, the Hope Scholarship Credit, and the Lifetime Learning Credit into the American Opportunity Tax Credit; repeal the exclusion for qualified tuition reductions; and repeal the deduction for qualified tuition and related expenses.

Employer-provided fringe benefits

The Conference Agreement would suspend the deduction and corresponding wage exclusion for qualified moving expenses from tax years 2018 through 2025. This elimination would have a taxable impact on relocation packages offered by employers to newly hired employees or current employees transferring to a new work location starting January 1, 2018. A narrow exception provides that the deduction and wage exclusion would remain in place for in-kind moving and storage expenses for members of the Armed Forces, their spouses, and dependents on active duty that move due to a military order and incident to a permanent change of station.

The Conference Agreement would eliminate the exclusion from gross income for qualified bicycle commuting reimbursements, effective for tax years 2018 through 2025. Under the Agreement, starting on January 1, 2018, bicycle commuting expense reimbursements paid by an employer to an employee would constitute taxable wages.

Code Sections 74(c) and 274(j) exclude from an employee's gross income employee achievement awards that are deductible and subject to a dollar limitation. An employee achievement award is an item of tangible personal property given to an employee in recognition of a length of service or safety achievement and meeting certain other requirements. The Conference Agreement would maintain the deduction and wage exclusion and also would apply certain rules in the proposed regulations defining tangible personal property. Under the Agreement, personal property would not include cash, cash equivalents (e.g., gift cards or gift certificates), vacations, meals, lodging, theater or sporting tickets, stocks, bonds, and other similar items. Employees would be allowed to choose from a limited selection of tangible personal property pre-approved by the employer.

Estate tax

The Conference Agreement would maintain the estate, gift, and generation-skipping transfer taxes (currently at a 40-percent tax rate). For estates of decedents dying and gifts made after 2017, the Agreement would double the exemption for all three taxes from $5,600,000 to $11,200,000 per person. The gift and estate tax exemptions would remain unified, so any use of the gift tax exemption during lifetime would decrease the estate tax exemption available at death. The current law allowing a 'step-up' in basis to fair market value at date of death will continue.

The current gift tax exclusion for annual gifts of up to $15,000 per donee (in 2018 as adjusted for inflation) would be retained, as well as the provisions for unlimited transfers directly to educational institutions and health care providers.

Observation: The increased exemption amounts are favorable developments for individuals with a taxable estate and may incentivize additional wealth transfers to family members and dynasty trusts. However, the scheduled sunset after 2025 raises possible 'clawback' concerns that must be taken into account.

Individual alternative minimum tax

The Conference Agreement would retain a modified individual AMT, with increased exemption amounts and exemption amount phase-out thresholds for 2017 through 2025. Under the Agreement, the AMT exemption amount is increased to $109,400 for joint filers and $70,300 for all other taxpayers (other than

estates and trusts). The phase-out thresholds are increased to $1 million for joint filers and $500,000 for all other taxpayers (other than estates and trusts). These amounts would be indexed for inflation.

Observation: In the past, the AMT has had a significant effect for taxpayers living in states with high income taxes because the deduction for state and local income taxes was not allowed in the AMT computation. With the increased exemption, the new limitation on the state and local income tax deduction, and the repeal of miscellaneous itemized deductions, fewer taxpayers will be subject to the individual AMT.

Tax-exempt organizations

The Conference Agreement contains several provisions affecting exempt organization excise taxes, the determination of unrelated business taxable income, and the charitable deduction (discussed above). The Agreement would impose a new excise tax on the net investment income of certain large private colleges and universities and a new entity-level excise tax on excess compensation paid by exempt organizations.

Excise taxes on net investment income

The Conference Agreement would impose a new 1.4-percent excise tax on the net investment income of private colleges and universities with at least 500 students, more than 50-percent of whom are located in the United States, and endowment assets of at least $500,000 per student, effective for tax years beginning after December 31, 2017. The determination of net investment income would be based on rules similar to the determination of net investment income under the Section 4940 excise tax applicable to private foundations. The determination of the '$500,000 per student' amount would be based on the aggregate fair market value of all assets held at the end of the preceding taxable year, excluding assets used directly in carrying out the institution's exempt purposes.

Observation: A Conference Agreement provision that would have limited the endowment excise tax only to private institutions with tuition-paying students was struck by the Senate parliamentarian as violating the Byrd rule, as discussed above.

For purposes of determining whether a college or university meets the asset-per-student threshold and for purposes of determining net investment income, assets and net investment income of a related organization (based upon control tests set forth in the Agreement) with respect to the college or university are treated as assets and net investment income, respectively, of the college or university, subject to certain exceptions.

Excise taxes on excess compensation

The Conference Agreement would impose a 21-percent excise tax on exempt organizations that pay compensation in excess of $1 million or make an 'excess parachute payment' to a covered employee for a taxable year. The organization itself would be subject to the new tax. The excise tax would apply to organizations exempt under Section 501(a), exempt farmers' cooperatives, governmental entities with income excluded under Section 115, and political organizations. The excise would apply to tax years beginning after 2017.

For this purpose, a covered employee means one of the five highest compensated employees (current or former) of the organization for the taxable year. An individual who is a covered employee would continue to be a covered employee in future years. Compensation means wages as defined for income tax withholding purposes, excluding designated Roth contributions, and includes compensation paid by the organization or by any person or governmental entity that is related to the organization (based on control tests set forth in the Agreement). The Agreement excludes from the definition of compensation and parachute payment compensation paid to a licensed medical professional (including a doctor, nurse, or veterinarian) that is directly related to the performance of medical or veterinary services by such professional, but compensation includes remuneration paid to such a professional in any other capacity.

Compensation is treated as paid when the right to receive the compensation no longer is subject to a substantial risk of forfeiture (based upon the definition under Section 457(f)). Therefore, the tax imposed by this provision can apply to the value of compensation that is vested, even if it is not yet received.

Compensation subject to the excise tax includes the entire amount of an excess parachute payment. The Agreement provides that 'excess parachute payments' are payments made on account of separation from employment to the extent they exceed three times a base amount average over a five-year period. The Agreement excludes from an excess parachute payment an amount paid to employees who are not highly compensated employees. A highly compensated employee is an employee, for the preceding year, that had compensation from the employer in excess of $120,000, and if the employer elects, was in the top-paid group of employees for such preceding year.

Unrelated business taxable income (UBTI)

For an organization with more than one unrelated trade or business, the Agreement would require UBTI first be computed separately with respect to each trade or business (without regard to the specific deduction). The organization's UBTI for a taxable year would be the sum of the amounts (not less than zero) computed for each separate unrelated trade or business, less the specific deduction. An NOL deduction would be allowed only with respect to a trade or business from which the loss arose. The result of the provision is that a deduction from one trade or business for a taxable year could not be used to offset income from a different unrelated trade or business for the same taxable year, which is allowed under present law.

The provision would apply to taxable years beginning after December 31, 2017. NOLs arising in a taxable year beginning before January 1, 2018, that are carried forward to a taxable year beginning on or after such date, would not be subject to the rules of the provision. Therefore, NOLs from years prior to 2018 may be utilized against future UBTI without regard to the trade or business that generated the loss.

The Agreement would require tax-exempt organizations to include in UBTI any expenses paid or incurred for providing qualified transportation fringe benefits, a parking facility used in connection with qualified parking, and on-premises gyms and other athletic facilities to the organization's employees. Making such expenditures subject to tax follows the non-deductibility of such expenses for taxable entities provided in the Agreement.

The Agreement does not include the provisions from the House bill that would have clarified that the tax on UBTI applies to all entities exempt from tax under Section 501(a) notwithstanding the entity's exemption under any other section of the Internal Revenue Code and that would have limited the research exclusion in Section 512(b)(9) only to fundamental research the results of which are freely made available to the public.

The Conference Agreement does not include the following exempt organizations provisions:

- The House bill provision that would have simplified the present-law two-tier excise tax on net investment income of private foundations.
- The House bill provisions that would have changed the requirements for private operating foundations that operate an art museum and would have provided a limited exception to the excess business holdings excise tax applicable to private foundations.
- The House bill provision that would have allowed churches and other exempt organizations to make political campaign statements in certain circumstances.
- The House bill provision that would have imposed additional disclosure requirements on sponsoring organizations of donor-advised funds.

Information reporting and withholding

Withholding tax on transfer of interest in partnerships engaged in a US trade or business

In July 2017, the Tax Court held that the sale or exchange of an interest in a partnership that is engaged in a US trade or business by a foreign partner generates foreign-source gain or loss. Under that decision, a transfer of such a partnership interest by a foreign partner resulting in gain no longer would be subject to withholding tax on effectively connected income (ECI) under Section 1446. The Tax Court decision effectively overturned Rev. Rul. 91-32, which held that the sale or exchange of a partnership interest by a foreign partner resulted in ECI if the partnership was engaged in a US trade or business.

The Conference Agreement effectively reverses the Tax Court's holding and codifies the position described in Rev. Rul. 91-32. Specifically, Section 864 is modified to treat the gain or loss from the sale of a partnership interest that is engaged in a US trade or business as ECI. To collect the tax on the gain, new Section 1446(f) requires the transferee (buyer) to withhold 10 percent on the amount realized in the sales transaction. Transfers that occur on or after November 27, 2017 receive ECI treatment.

Withholding is not required if the transferor provides a certification that it is a US person. The partnership is required to verify that the transferee properly withheld tax on the proceeds. If the transferee did not withhold, then the partnership is required to withhold such amounts from distributions to the transferee. The legislation also directs the promulgation of regulations allowing a broker, in its capacity as agent of the transferee, to perform the required withholding. This withholding provision will be effective for sales and exchanges of partnership interests after December 31, 2017.

The legislation also creates an additional layer of tax withholding requirements for partnerships engaged in a US trade or business. In addition to the continued withholding on ECI under Section 1446, partnerships will be required to monitor transfers of interests by

existing foreign partners and potentially withhold on subsequent distributions to the acquirers of such interests. The provision allowing brokers to perform the required withholding, however, should shield publicly traded partnerships from these requirements. Such regulatory provisions also allow non-publicly traded partnerships and their partners to use brokers to satisfy the new withholding tax requirements.

Withholding taxes reduced on certain amounts subject to FIRPTA

The legislation reduces the rate of withholding tax on allocations or distributions related to gain from the disposition of US real property interests (USRPI) to certain foreign persons. Under the current provisions of Section 1445 (FIRPTA), the withholding rate is generally 15 percent of the amount realized. However, certain transactions are subject to 35-percent withholding. The higher rate applies to foreign corporate distributions that are treated as gain from the disposition of USRPI (the rate applies to the gain recognized and not the amount realized) and on distributions by regulated investment companies (RICs) and real estate investment trusts (REITs) that were treated as gain from the disposition of USRPI. Gain from the disposition of a USRPI by a domestic partnership is not subject to Section 1445 withholding and is instead subject to Section 1446 withholding to the extent the gain is allocable to a foreign partner. The rate under Section 1446 is the highest applicable rate imposed by the Internal Revenue Code on the applicable type of taxpayer, with certain exceptions.

Under the legislation, the 35-percent rate is changed to reflect the current corporate tax rate set forth in the Code (which is reduced to 21 percent under the Conference Agreement, as discussed above) for the following:

- Gains from USRPI realized by US partnerships, trusts and estates that are allocable to foreign persons or trusts (or portions thereof) treated as owned by foreign persons
- Distributions to foreign persons by foreign corporations that are treated as gain from the disposition of USRPI
- Distributions to foreign persons by RICs or REITs that are treated as gain from the sale or exchange of USRPI

Observation: This provision does not change the substantive application of FIRPTA, but reduces the applicable withholding tax rate on certain types of transactions to be consistent with the lower 21-percent corporate tax rate. The legislation also removes the static tax rate and links the rate to the general corporate income tax rate. Any future adjustments to the general corporate income tax rate will automatically apply to these types of USRPI transactions.

Information reporting for payment of certain fines, penalties, and other amounts

As discussed above, the Conference Agreement eliminates the deductibility of payments made to government agencies or equivalent entities tasked with enforcement of laws as the result of a settlement agreement or court order relating to a violation of such law or an investigation into the potential violation of law. To assist in enforcement of this provision, the legislation requires government agencies or equivalent entities to report to the IRS and the taxpayer the aggregate amount paid if such amount is at least $600. The report must specify the aggregate amount paid, as well as separately report amounts for restitution or remediation of property and amounts paid for correction of the violation or potential violation. The government entity or equivalent must perform such reporting at the time the agreement is entered into or order is finalized.

This provision will be effective for amounts paid on or after the date of enactment of the legislation or where payment is pursuant to an agreement or order finalized on or after the date of enactment. The provision does not apply to amounts paid after enactment that are pursuant to an agreement or order entered into prior to the date of enactment.

Observation: This provision creates a new type of information return intended to allow the IRS to more easily perform its enforcement of the new provision that eliminates dedications for the relevant claims. It will create additional administrative burdens for federal, state, and local governments and other entities tasked with law enforcement functions.

Other provisions

The Conference Agreement adopts a provision from the Senate bill that would effectively repeal the Affordable Care Act (ACA) individual mandate by reducing the ACA individual shared responsibility payment to zero.

Observation: The Congressional Budget Office has estimated that ending the individual mandate will result in 13 million more Americans choosing not to purchase health insurance relative to current law by 2027. Because many of these 13 million are expected to be younger or healthier individuals, premiums in the nongroup market are projected to increase by approximately 10 percent.

The Agreement adopts the Senate proposal to allow oil and gas exploration in the Arctic National Wildlife Refuge (ANWR).

Regulatory implementation process

With passage of new legislation, the Treasury Department and IRS Office of Chief Counsel will be under pressure to issue guidance in various forms to interpret and implement the revised provisions of the Internal Revenue Code. Under current-law administrative procedures, Treasury and the IRS are expected to issue temporary and proposed regulations and request comments from the public and other stakeholders regarding the new guidance. The government also may issue other types of non-regulatory guidance, including revenue rulings, revenue procedures, and notices, to more expeditiously address pressing issues associated with implementing the new legislation.

All regulations projects originate in the Office of Chief Counsel with jurisdiction over the subject-matter of the regulations, in coordination with Treasury's Office of Tax Policy. Following publication of temporary or proposed regulations, the public and other stakeholders will be provided an opportunity to submit comments on the positions set forth in the regulations. This notice and comment period is intended to satisfy requirements of the Administrative Procedure Act prior to the regulations becoming final. Other types of non-regulatory guidance are not normally required to satisfy these notice and comment requirements prior to issuance.

In light of the general reduction in budget and staffing at the IRS, including the Office of Chief Counsel, it is not clear how quickly guidance will be issued. Moreover, all temporary, proposed, and final regulations require final approval by the IRS Deputy Commissioner for Services and Enforcement, as well as the Treasury Assistant Secretary (Tax Policy). This will require a prioritization of guidance projects in order to ensure that the most urgent items are addressed in a timely manner. Regulations also must go through review by the White House Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA), before final regulations are published.

Observation: OIRA review is not necessary for sub-regulatory guidance, which will add to the attractiveness of using notices, revenue rulings, and revenue procedures in the immediate period following enactment of the new legislation. Because items of non-regulatory guidance also do not require notice and comment, it is anticipated that they will be the first to be issued following passage of new legislation.

The IRS also will need to make changes to numerous forms, instructions for revised forms, and publications.

Revenue effects

The Conference Agreement was estimated by JCT staff to increase the on-budget deficit by $1.456 trillion over 10 years, which is in line with the FY 2018 budget reconciliation instructions that limit the overall revenue cost of the legislation to $1.5 trillion over 10 years. While the corporate rate reduction and international reforms are proposed to be permanent, the Agreement sunsets nearly all individual tax provisions (including the pass-through deduction) at the end of 2025 in order to comply with Senate budget reconciliation rules.

JCT staff are expected to provide an updated macroeconomic analysis for the final Conference Agreement. JCT staff released a macroeconomic analysis of the Finance Committee bill as reported on November 30 that estimates that the legislation would increase economic output (as measured by Gross Domestic Product) by about 0.8 percent on average over the 10-year budget window. That increase in income would reduce the conventionally estimated $1.414 trillion revenue loss of the Finance Committee bill by $458 billion over the budget period. JCT projects that this budget effect would be partially offset by an increase in interest payments on the Federal debt of about $50 billion over the same period. As a result, JCT projects that the Finance Committee bill would increase federal budget deficits by just over $1 trillion over 10 years. For a copy of the JCT macroeconomic analysis of the Finance Committee bill, click here.

JCT staff also released a macroeconomic analysis for the House-passed version of the HR 1 that projected a similar level of economic growth effects and overall net deficit increase of just over $1 trillion over 10 years. For a copy of the JCT macroeconomic analysis of the House bill, click here.

Next steps

House Ways and Means Chairman Kevin Brady (R-TX) has stated that Congress in 2018 will likely need to consider technical corrections to HR 1, considering the magnitude of the revisions to current tax law. In the case of the Tax Reform Act of 1986 (enacted October 22, 1986), technical corrections were enacted November 10, 1988, in the Technical and Miscellaneous Revenue Act of 1988 (TAMRA).

Observation: Future Congressional action to consider technical corrections could require bipartisan cooperation. While substantive revisions to HR 1 could considered be under the budget reconciliation process, technical corrections are traditionally defined as having no significant revenue effect and thus would not be permitted under the Senate reconciliation 'Byrd rules,' as

discussed above. The passage of HR 1 on a party-line basis with only Republican votes may limit the prospects for bipartisan cooperation to resolve specific issues related to the 2017 tax reform legislation, just as passage of the Affordable Care Act with only Democratic votes made it difficult for Republicans to agree to technical corrections to the 2010 healthcare law.

Observation: A future Congress and President may agree to extend or make permanent many, if not all, of the temporary individual and business tax provisions. For example, former President Barack Obama and Congress in 2012 agreed to make permanent most of the tax cuts enacted in 2001 and 2003 under former President George W. Bush. The 2012 'fiscal cliff' legislation was enacted under regular legislative procedures so budget reconciliation restrictions limiting the resulting increase in projected federal budget deficits did not apply.

The takeaway

HR 1 is on track to be the most historic tax reform enacted since the Tax Reform Act of 1986. The current legislation represents years of effort to enact a reform of US tax law providing a more competitive tax system for business taxpayers and improved economic opportunities for individuals and families.

Stakeholders should remain engaged as the Treasury Department and the IRS begin the regulatory process to implement the legislation.

For more information on the Conference Agreement

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

Of further interest

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

Let's talk

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

Tax Policy Services

Pam Olson
(202) 414-1401
pam.olson@pwc.com

Rohit Kumar
(202) 414-1421
rohit.kumar@pwc.com

Scott McCandless
(202) 312-7686
scott.mccandless@pwc.com

Todd Metcalf
(202) 346-5119
todd.metcalf@pwc.com

Larry Campbell
(202) 414-1477
larry.campbell@pwc.com

Don Carlson
(202) 414-1385
donald.g.carlson@pwc.com

Janice Mays
(202) 312-7589
janice.a.mays@pwc.com

Andrew Prior
(202) 414-4572
andrew.prior@pwc.com

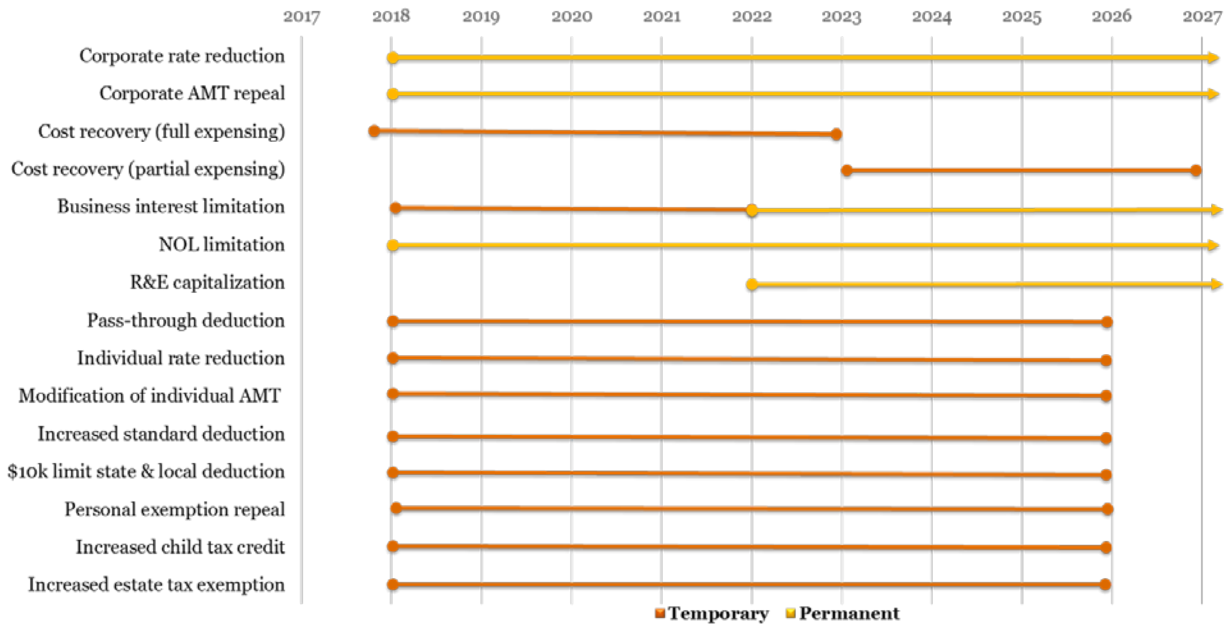
Kevin Levingston
(678) 419-1235
kevin.levingston@pwc.com

National Economics & Statistics

Drew Lyon
(202) 414-3865
drew.lyon@pwc.com

Peter Merrill
(202) 414-1666
peter.merrill@pwc.com

Jon Lieber
(202) 312-0841
jon.lieber@pwc.com



Note: Partial expensing is phased-out between 2023 and 2026. The business interest expense limitation provision is based on adjusted taxable income as measured by EBITDA through 2022, and as measured by EBIT thereafter.

Proposal/ Current law	House bill	Senate bill	Conference Agreement
	General business tax reform proposals		
Corporate tax rates 35% rate	20% rate for tax years beginning after 12/31/2017. A blended rate applies for fiscal-year taxpayers.	20% rate for tax years beginning after 12/31/2018. A blended rate applies for fiscal-year taxpayers.	21% rate for tax years beginning after 12/31/2017. A blended rate applies for fiscal-year taxpayers.
Corporate AMT 20% corporate AMT rate	Corporate AMT repealed after 2017. AMT credits are refundable from 2019 through 2022.	No provision.	Corporate AMT repealed after 2017. Prior year AMT credits refundable from 2018 to 2021.
Cost recovery (full expensing) Recover investment over the investment's applicable life under MACRS or ADS	100% full expensing for investments made after 9/27/ 2017 and before 1/1/ 2023 (additional year for certain qualified property with longer production period). Excludes property used by a regulated public utility or in a real property trade or business. Extends to used property.	Generally the same as HR 1, except that the Senate bill would phase-down full expensing by 20% a year in the case of property placed in service after 12/31/2022 and before 1/1/2027 (after 12/31/2023 and before 1/1/2028 for longer production period property and aircraft). The Senate bill also does not exclude qualifying property other	Generally the same as the Senate bill but extends expensing to used property (as in HR 1) and follows the House bill's application of the present-law phase-down of bonus depreciation to property acquired before 9/28/2017, and placed in service after 9/27/2017, as well as the present-law phase-down of the Section 280F increase amount in the limitation on the

		than qualified improvement property used in a real property business and does not expand expensing to used property.	depreciation deductions allowed with respect to certain passenger automobiles acquired before 9/28/2017, and placed in service after 9/27/2017.
Business interest expense Deductible as incurred	**Two tests would apply:** First, limited to the sum of business interest income plus 30% of the adjusted taxable income (defined similar to EBITDA). Would not apply to certain regulated public utilities and real property trades or businesses. **Worldwide leverage test:** Second, limits deduction of interest by a US corporation that is part of an 'international financial reporting group' (IFRG) to US corporation's share of the IFRG's EBITDA (expressed as a percentage), multiplied by 110% of the IFRG's reported net interest expense. Both limitations apply to both related-party and unrelated-party debt. The harsher of the two limitations will apply. Disallowed interest is permitted to be carried forward 5 years.	**Two tests would apply:** First, limited to the sum of business interest income plus 30% of the adjusted taxable income (defined similar to EBIT, i.e., without add-back of depreciation and amortization) of the taxpayer for the taxable year. Would not apply to certain regulated public utilities and at the taxpayer's election certain real property trades or businesses. **Worldwide leverage test:** Second, limits deduction of net interest expense of a US corporation that is part of a 'worldwide affiliated group' to the extent the US corporation's domestic indebtedness exceeds a percentage of the indebtedness it would have if its domestic debt: equity ratio were the same as that of the worldwide group. The percentage used in determining excess indebtedness phases down from 130% in 2018 to 110% in 2022 and thereafter. Both limitations apply to both related-party and unrelated-party debt. The bill explanation states that the harsher of the two limitations will apply. Disallowed interest may be carried forward indefinitely.	**One test would apply:** Limited to the sum of business interest income plus 30% of the adjusted taxable income of the taxpayer for the taxable year. Adjusted taxable income is defined similar to EBITDA for taxable years beginning after 12/31/2017 and before 1/1/2022, and is defined similar to EBIT for taxable years beginning after 12/31/2021. Would not apply to certain regulated public utilities and certain electric cooperatives, floor plan financing interest, and at the taxpayer's election certain real property trades or businesses. Limitation applies to both related party and unrelated party debt. Disallowed interest is allowed to be carried forward indefinitely.
Pass-through entities Income is passed through to the owners to be taxed at the individual rates.	25% maximum rate with exclusion for certain pass-through business income. Guardrails around what qualifies as business income, including a general exclusion for income from any active business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing	Creates a 23% deduction for non-wage portion of pass-through income. Deduction is limited to 50% of individual's W-2 wages for taxpayers with income **over** $500,000 (married) or $250,000 (individuals). The 50% limit is phased in over	Creates a 20% deduction for non-wage portion of pass-through income. Deduction is limited to the greater of (a) 50% of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25% of the W-2 wages with respect to the qualified

	arts, consulting, athletics, financial services, brokerage services, investing, trading, or dealing in securities, partnership interests, or commodities (specified services business income). 9% tax rate, phased in over 5 years, for the first $75,000 of net business income for joint returns ($37,500 for individuals) in lieu of the 12% rate. Phased out at $225,000 of taxable income.	the next $100,000 (married) of taxable income ($50,000 for individuals). The Senate bill includes language modifying the Finance Committee bill to broaden eligibility requirements to include income from publicly traded partnerships. The deduction does not apply to specified services business income, except when income of taxpayers married filing jointly does not exceed $500,000 ($250,000 for individuals). The benefit of the deduction is phased out over the same limits as above. Sunsets after 2025.	trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property for taxpayers with income **over** $315,000 (married) or $157,500 (individuals). The 50% limit is phased in over the next $100,000 (married) of taxable income ($50,000 for individuals). The conference agreement broadens eligibility requirements to include income from trusts and estates. The deduction does not apply to specified services business income, except when income of taxpayers married filing jointly does not exceed $315,000 ($157,500 for individuals). The benefit of the deduction is phased out over the same limits as above. Sunsets after 2025.
Domestic production Deduction up to 9% of qualified income for items manufactured, produced, grown, or extracted in US (6% of qualified income for oil & gas production).	Repeals Section 199 deduction for taxable years beginning after 12/31/2017.	Repeals Section 199 for taxable years beginning after 12/31/2018 (12/31/2017 for pass-through entities).	Same as House bill.
R&D Regular credit – 20%	Maintains R&D credit. Section 174 research and experimentation expenditures must be capitalized and amortized over a 5-year period for expenditures paid or incurred after 2022 (15 years for foreign expenditures).	Maintains R&D credit. Section 174 research and experimentation expenditures must be capitalized and amortized over a 5-year period for expenditures paid or incurred after 2025 (15 years for foreign expenditures).	Same as Senate bill, except that Section 174 capitalization and amortization applies to amounts paid or incurred in tax years beginning after 12/31/2021.
Net operating losses Carryback up to 2 years and carryforward up to 20 years	Limit to 90% of income, with indefinite carryforward and increase by interest factor; no carryback.	Limit to 90% of income, indefinite carryforward; no carryback. Limit to 80% of taxable income beginning after 12/31/2022.	Same as the Senate bill, except that limits to 80% of taxable income (determined without regard to the deduction) for losses arising in tax years beginning after 12/31/2017.
Like-kind property Allows deferral of gain from an exchange of 'like-kind' property	Repeals like-kind exchange except for real property.	Same as House bill.	Same as Senate bill.

Accounting methods C corporations/ partnerships with a C-corporation partner may only use the cash method of accounting if their average annual gross receipts for the prior 3 tax years do not exceed $5 million for all prior tax years for tax years beginning after 12/31/2017 and indexed for inflation after 2018. Taxpayers with average annual gross receipts for the prior 3 tax years that do not exceed $10 million are exempt from the UNICAP and the percentage of completion method.	Increase receipts limit to $25 million.	Increase receipts limit to $15 million.	Same as House bill.
Private activity bonds Allows for the issuance of tax-exempt bonds on behalf of private parties (private activity bonds), including qualified Section 501(c)(3) organizations.	Eliminates tax-exempt interest from qualified private activity bonds.	No change from current law.	Same as Senate bill.
Advance refunding bonds Interest on advance refunding bonds is tax-exempt.	Repeals exemption for any bond issued after 1/1/2018.	Repeals exemption.	Same as Senate bill.
Sale or exchange of patents Certain self-created property, including patents, is treated as a capital asset.	Repeals Section 1235, resulting in the gain or loss from a disposition to be ordinary in character	No change from current law.	Same as Senate bill.
Revision of treatment of contributions to capital The gross income of a corporation generally does not include contributions to its capital. A debtor corporation that acquires its own debt from a shareholder as a	Repeals both provisions, and adds new Section 76, which provides that the gross income of any entity includes any contribution to capital. For corporations, the gross income of would include contributions to its capital only to the extent that the amount of money and the fair market value of property contributed to the corporation exceeds the fair market value of any stock that is issued in exchange for such money or property.	Not provided	Preserves the current provision under which a corporation's gross income generally does not include contributions to capital, but provides that the term "contributions to capital" 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

contribution to capital generally will not recognize cancellation of debt income except to the extent the shareholder's basis in such debt is less than the adjusted issue price.			governmental entity or civic group (other than a contribution made by a shareholder as such). Section 118, as modified, continues to apply only to corporations.
8% surtax on life insurance company income Not provided	Imposes 8% surtax on life insurance company taxable income beginning 1/1/2018. The surtax is identified as a 'placeholder'.	Not provided.	Same as Senate bill.
Capitalization of certain policy acquisition expenses Certain policy acquisition expenses, such as commissions, are required to be capitalized over 120 months. A special rule provides for 60-month amortization of the first $5 million of certain policy acquisition expenses, with a phase-out.	Not provided	The provision extends the amortization period for specified policy acquisition expenses from a 120-month period to a 180-month period.	Follows the Senate bill with modifications.
FDIC premium deduction FDIC premiums are deductible once the all events test for the premium is satisfied.	Phases out deductions for any FDIC premiums paid by financial institution groups with assets between $10 billion and $50 billion.	Same as House bill.	Same as Senate bill.
Entertainment deduction Employers may deduct 50% of business-related entertainment costs.	Repeals deduction	Repeals deduction	Same as Senate bill.
Moving expense deduction Provides deductions for certain moving expenses.	Repeals deduction, except for those in the Armed Forces.	Repeals deduction, except for those in the Armed Forces.	Same as Senate bill.
Moving expense reimbursement exclusion Employer-provided reimbursements for certain moving expenses are excluded from income.	Repeals	Repeals	Same as Senate bill.
Transportation and parking	Repeals	Repeals	Same as Senate bill.

Employers may deduct cost of certain benefits provided, such as transportation and parking.			
Work Opportunity Tax Credit Employers receive tax credits for hiring individuals from certain groups, such as veterans.	Repeals	No change from current law.	Same as Senate bill.

International business tax reform proposals

Proposal/ Current law	**House bill**	**Senate bill**	**Conference Agreement**
International tax regime 'Worldwide' system foreign tax credits to mitigate double taxation	'Territorial' system 100% foreign dividend exemption	'Territorial' system 100% foreign dividend exemption	Same as Senate bill.
Repatriation 'toll tax' Currently no provision. Previously untaxed foreign earnings: • 35% corporate rate when repatriated with foreign tax credit	Previously untaxed foreign earnings: • 14% cash and cash-equivalents • 7% non-cash assets • Payable over 8 years in equal installments • Proportional reduction in foreign tax credits attributable to previously untaxed foreign earnings	Previously untaxed foreign earnings: • 14.49% cash and cash-equivalents • 7.49% non-cash assets • Payable over 8 years in increasing installments • Proportional reduction in foreign tax credits attributable to previously untaxed foreign earnings	Previously untaxed foreign earnings: • 15.5% cash and cash-equivalents • 8% non-cash assets • Payable over 8 years in increasing installments • Proportional reduction in foreign tax credits attributable to previously untaxed foreign earnings
Anti-base erosion regime (Subpart F) Subpart F anti-deferral regime includes CFC's insurance income, foreign base company income, etc., with foreign tax credit	Subpart F generally maintained; A US shareholder in a CFC must include 50% of its 'foreign high return amount' (FHRA) in gross income. A US shareholder's FHRA is equal to amount by which its aggregate pro rata share of 'net CFC tested income' exceeds a specified return. Specified return is a percentage (7% plus the short-term AFR) of the shareholder's aggregate pro rata share of CFC qualified business asset investment (QBAI), and is reduced by interest expense taken into account in determining net CFC tested income.	Subpart F generally maintained; A US shareholder in a CFC must include its GILTI in gross income. A US shareholder's GILTI is equal to amount by which its aggregate pro rata share of net CFC tested income exceeds a specified return. Specified return is equal to 10% of shareholder's aggregate pro rata share of QBAI. A domestic corporation can deduct 50% (37.5% after 2025) of GILTI included in gross income.	Follows Senate bill with certain modifications. Specified return is equal to 10% of shareholder's aggregate pro rata share of QBAI and is reduced by interest expense taken into account in determining net CFC tested income. GILTI after the 50% deduction is effectively taxed at 10.5% (13.125% after 2025) before consideration of foreign taxes.
Foreign investment in US property (Section 956)	Domestic corporations are not subject to Section 956 (regardless of whether that CFC is owned through a domestic corporation).	Domestic corporations who are US shareholders in the CFC are not required to recognize income on	No provision. Section 956 is unchanged.

CFC's are required to include currently in income their pro rata shares of the corporation's untaxed earnings invested in certain items of US property.		additional investment in the United States.	
Incentive for US production for sale to foreign customers Not provided	Not provided	A 37.5% deduction is allowed for foreign-derived intangible income produced in the US. The deduction is reduced to 21.875% for tax years starting after 12/31/2025.	Follows Senate bill with certain modifications.
Anti-base erosion regime and related party payments	Imposes a 20% excise tax on certain amounts paid by a US corporation to a foreign corporation if both corporations are part of the same international financial reporting group. Excise tax does not apply to amounts treated by foreign recipient as ECI; foreign recipient can elect to treat payments from a US corporation that would otherwise be subject to excise tax as ECI. The excise tax does not apply to FDAP income to the extent the income is subject to the 30% withholding tax.	Imposes minimum tax equal to excess of (i) 10% of taxable income determined without regard to base erosion payments (i.e., deductible payments to a related foreign person); over (ii) regular tax liability (determined after reduction by credits other than the R&D credit). For tax years beginning after 12/31/2025, the regular tax is reduced by all credits (including GBC). Rate above is increased to 12.5% for taxable years beginning after 12/31/2025. Modified taxable income is reduced by payments to the extent they are subject to the 30% tax on FDAP income. Denies a deduction for interest or royalties paid or accrued to a related party in connection with a hybrid transaction or a hybrid entity, to the extent that the related party does not have a corresponding inclusion or is allowed a deduction with respect to the amount paid for foreign tax purposes.	Follows Senate bill with certain modifications. For base erosion payments paid or accrued in taxable years beginning after December 31, 2017, the base erosion minimum tax amount is 5% of taxable income determined without regard to base erosion payments (i.e., deductible payments to a related foreign person); over (ii) regular tax liability reduced by credits other than R&D credit and a portion of applicable Section 38 credits. Rate above is increased to 10% for taxable years beginning after 12/31/2018 and 12.5% for taxable years beginning after 12/31/2025. Clarified scope and rates with respect to financial service and insurance companies.
Look-through rule 'Look-through' rule provides that a US parent can exclude passive income received	Makes the 'look-through' rule permanent.	Makes the 'look-through' rule permanent.	No provision.

by one CFC from a related CFC (expires after 2019).			
Limitation on losses Gain recognized by a US shareholder on the sale or exchange of stock in a foreign corporation is generally treated as a dividend distribution to the extent of the foreign corporation's E&P.	A domestic corporation is required to reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividend received, but only for purposes of determining the amount of a loss on the sale or exchange of the stock.	Appears to be same as the House bill, but recapture amount limited to amount of deduction allowed to the taxpayer for foreign dividends received in taxable year of the transfer.	Same as Senate bill.
Foreign tax credit A taxpayer can generally take a credit or deduction for foreign taxes paid or accrued. US shareholder may be deemed to pay foreign income taxes paid by a foreign corporation when the US shareholder receives a dividend from a foreign corporation or includes earnings of a foreign corporation in gross income.	Repeals deemed paid tax credit for dividends received from a foreign corporation. Retains deemed paid tax credit for subpart F inclusions. Proposal eliminates need for computing and tracking cumulative tax pools. No foreign tax credit or deduction permitted for any taxes paid or accrued with respect to any dividend subject to the new deduction for foreign dividends.	Same as House bill.	Same as HR 1, with certain modifications.
Foreign tax credit limitation Amount of credit is subject to a limitation based on the taxpayer's foreign source income. Limitation applies separately with respect to passive category income and general category income ('baskets').	Adds separate basket for the foreign high return inclusion.	Adds separate baskets for foreign branch income and GILTI.	Same as Senate bill.
Allocation of interest expense Members of a US affiliated group can allocate interest expense based on fair market value or adjusted tax basis of assets.	No change from current law.	Members of a US affiliated group must allocate interest expense based on the adjusted tax basis of assets.	Same as Senate bill.
Transfers of intangible property from CFCs to US shareholders A shareholder recognizes ordinary income on a distribution out of a corporation's E&P. Distributions in excess of E&P reduce a shareholder's basis in the stock of distributing corporation, and	No change from current law.	Applies to distributions by a CFC of certain intangible property to a US shareholder before the last day of the CFC's third taxable year beginning after 12/31/2017. Fair market value of the property distributed is treated as not exceeding its adjusted basis.	No provision.

distributions in excess of stock basis are treated as gain from the sale or exchange of property. A distributing corporation recognizes gain on a distribution of appreciated property. A shareholder's basis in distributed property is equal to its fair market value.		US shareholder's adjusted basis in the stock of a CFC is increased by amount of distribution that would otherwise be included in shareholder's gross income. Shareholder's basis in property distributed is reduced by amount of increase.	
Transfers of property from US to foreign corporation In general, an exchange in which a US person transfers property to a foreign corporation is not eligible for non-recognition treatment. Under the active trade or business exception, certain property transferred to a foreign corporation for use in the active conduct of a trade or business outside of the United States is eligible for non-recognition.	No change from current law.	Repeals the active trade or business exception.	Same as Senate bill.

Individual tax reform proposals

Proposal/ Current law	**House bill**	**Senate bill**	**Conference Agreement**
Individual rates Seven rate brackets (10%, 15%, 25%, 28%, 33%, 35%, and 39.6%).	Four rate brackets (12%, 25%, 35%, and 39.6%). Phases out benefit of 12% rate for AGI exceeding $1 million ($1.2 million married filing joint).	Seven rate brackets (10%, 12%, 22%, 24%, 32%, 35%, and 38.5%). Sunsets after 2025.	Seven rate brackets (10%, 12%, 22%, 24%, 32%, 35%, and 37%). Sunsets after 2025.
AMT AMT imposed when minimum tax exceeds regular income tax.	Repeals AMT.	Increases individual AMT exemption amounts and phase-out thresholds in lieu of full repeal. Sunsets after 2025.	Increases individual AMT exemption amounts (same as Senate bill) and phase-out thresholds (higher than Senate bill). Sunsets after 2025.
Individual – standard deduction $6,500 for single filers/ $13,000 joint filers (2018)	$12,200 for single filers/ $24,400 joint returns (adjusted for inflation based on chained CPI)	$12,000 for single filers/ $24,000 joint returns (adjusted for inflation based on chained CPI). Increased deduction sunsets after 2025. Chained CPI does not expire after 2025.	Same as Senate bill.
Personal exemption	Repeals deduction for personal exemptions.	Repeals deduction for personal exemptions. Sunsets after 2025.	Same as Senate bill.

$4,150 for each person, spouse, and dependents (2018)			
Overall itemized deductions Itemized deduction phase out begins at $320,000 for joint filers and $266,700 for single filers (2018)	No overall limitation on itemized deductions. Repeals certain other itemized deductions.	No overall limitation on itemized deductions. Repeals certain other itemized deductions. Sunsets after 2025.	Same as Senate bill.
State and local tax deduction Itemized deductions for state and local income and sales taxes and state and local property taxes.	Repeals state and local income and sales tax deductions but retains the deduction for state and local property taxes up to $10,000.	Same as House bill.	Retains a deduction in aggregate for state and local property taxes, state and local income taxes, or state and local general sales taxes up to $10,000. Sunsets after 2025.
Mortgage interest deduction Mortgage interest deduction limited to acquisition debt of $1 million and home equity debt of $100k on a principal and second home.	Retains for existing mortgages; limited to $500,000 for newly purchased homes, no longer available for a second home.	Retains current law but repeals interest on home equity indebtedness. Sunsets after 2025.	Retains current law limitation for existing acquisition debt; acquisition debt limited to $750,000 for newly purchased homes, available for a first or second home. Repeals deduction for non-acquisition HELOCs. Sunsets after 2025.
Child tax credit $1,050 per child	$1,600 per child ($1,000 refundable) and a $300 credit for non-child dependents.	$2,000 per child ($1,000 refundable) and $500 for non-child dependents. Sunsets after 2025.	$2,000 per child ($1,400 refundable) and $500 for non-child dependents. Sunsets after 2025.
Estate Tax Maximum 40% rate for taxable estates exceeding $5.6 million (2018 indexed amount)	Doubles exemption amounts until repeal of estate tax in 2024.	Doubles exemption amounts. Sunsets after 2025.	Same as Senate bill.
Carried interest Taxed at capital gains rates	Imposes a 3-year holding period requirement for qualification as long-term capital gain with respect to certain partnership interests received in connection with the performance of services.	Same as House bill.	Same as House bill and Senate bill.
ACA Individual Mandate For tax year 2017, the payment is 2.5% of a household's AGI or a flat rate of $695/adult and $347.50/child, up to a maximum of $2,085.	No change	Reduces the amount of the individual mandate payment to $0 beginning after December 31, 2018.	Same as Senate bill
Excessive employee remuneration for covered officials	Compensation paid by publicly traded entities to executives is subject to a $1 million deduction limit. Repeals the exception for performance-based compensation.	Same as House bill, with transition rule.	Same as Senate bill.

Corporate salaries of 'covered officials' have a $1 million cap on deduction. Exception for performance-based compensation.			
Minimum age for in-service distributions Allows for in-service distributions at the age of 62 for defined benefit plans and state and local government defined contribution plans.	Reduces the age to 59 and a half.	No change from current law.	Same as Senate bill.
American Opportunity Tax Credit Tax credit of up to $2,500 of the cost of tuition, fees, and course materials. Also, 40% of the credit is refundable. The credit is only available for the first four years of a student's post-secondary education.	The American Opportunity Tax Credit, the Hope Scholarship Credit, and the Lifetime Learning Credit would be consolidated into the American Opportunity Tax Credit. The credit is available for a fifth year of a student's post-secondary education but is limited to $1,250.	No change from current law.	Same as Senate bill.
Other provisions related to education Provisions related to education: •Provides for an above-the-line deduction for interest payments on qualified education loans for qualified higher education expenses •Provides for an above-the-line deduction for certain qualified tuition and related expenses •Excludes from income interest on US savings bonds used to pay qualified higher education expenses •Excludes from gross income of qualified tuition reductions provided by educational institutions •Excludes from gross income employer-provided education assistance	Repeals the following incentives: • Interest deduction on qualified education loans • Deduction for qualified tuition and related expenses • Exclusion for interest from US savings bonds used to pay qualified higher education expenses • Exclusion of qualified tuition reductions by educational institutions •Exclusion for employer-provided education expenses	No change from current law.	Same as Senate bill

Exclusion of gain from sale of a principal residence Allows individuals to exclude gain of up to $250,000 (or $500,000 for joint filers) from the sale of a principal residence who own and use a house for 2 of the previous 5 years. The exclusion can only be used once every 2 years.	The capital gain exclusion of $500,000 (for married filing jointly) would be limited to taxpayers who own and use a house for 5 out of the previous 8 years. The exclusion could only be used once every 5 years. The exclusion would start to phase out one dollar for every dollar that the taxpayer's AGI exceeds $500,000 (married filing jointly).	The capital gain exclusion of $500,000 (for married filing jointly) would be limited to taxpayers who own and use a house for 5 out of the previous 8 years. The exclusion could only be used once every 5 years. Sunsets after 2025.	No provision (retains current law).

Stay current and connected. Our timely news insights, periodicals, thought leadership, and webcasts help you anticipate and adapt in today's evolving business environment. Subscribe or manage your subscriptions at:

pwc.com/us/subscriptions

© 2017 PricewaterhouseCoopers LLP, a Delaware limited liability partnership. All rights reserved. PwC refers to the United States member firm, and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.

SOLICITATION

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

At PwC, our purpose is to build trust in society and solve important problems. PwC is a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com/US