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biggest change to tax laws since 1986. The bill passed on a mostly party line vote and now heads to the Senate where it is expected to see a close vote.

Dec. 19, 2017



The House of Representatives passed the Tax Cuts and Jobs Act on Tuesday, the biggest change to tax laws since 1986. The bill passed on a mostly party line vote, 227-203, with two members not voting. All House Democrats voted against the bill, and were joined by 12 Republican Representatives voting no.

The bill initially hit a snag after the first vote, because the Senate Parliamentarian determined that three provisions in the bill may have violated Senate rules. The House is expected to revote on the bill on Wednesday morning. The Senate is expected to still hold a vote on Tuesday evening of a version with those provisions

removed. The provisions that will have to be removed involved using Sec. 529 college

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file their 2018 taxes in April of 2019, although wage earners may see differences to the amounts withheld from their paychecks before then.

Among the main changes are new tax brackets and the elimination of many itemized deductions. In general, the new tax rate structure means lower brackets for most filers, with the top rate dropping to 37% from 39.6%. The 10% bracket now extends to almost \$10,000 for individuals and \$19,000 for joint filers, which doubles the amount of income taxed at the lowest rate. The standard deduction has also been doubled. The corporate tax rate is permanently dropped from 35% to 21%.

<b>Tax Rate</b>	<b>Income Range for Individuals</b>	<b>Income Range for Married Joint Filers</b>
10%	\$0 – \$9,525	\$0 – \$19,050
12%	\$9,526 – \$38,700	\$19,051 – \$77,400
22%	\$38,701 – \$82,500	\$77,401 – \$165,000
24%	\$82,501 – \$157,500	\$165,001 – \$315,000
32%	\$157,501 – \$200,000	\$315,001 – \$400,000
35%	\$200,001 – \$500,000	\$400,001 – \$600,000
37%	\$500,001 and Up	\$600,001 and Up

Following are more key tax reform provisions of the tax bill, according to an analysis by the tax group at the law firm [BakerHostetler](#):

## For individual taxpayers:

- The current seven-bracket structure remains, but the income thresholds and current rates of 10, 15, 25, 28, 33, 35 and 39.6 percent change, with rates under the Act set at 10, 12, 22, 24, 32, 35 and 37 percent, effective Jan. 1, 2018. The top individual tax rate of 37 percent applies for couples with taxable income of \$600,000 or more and individuals with taxable income of \$500,000 or more.

- Retention of the individual AMT, but with higher exemption amounts (\$109,400

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- Doubling of the limit on the credit to \$2,000 (\$4,000 for married couples), and permission to use Section 529 accounts to save for certain elementary and secondary education expenses as well as for higher education. Graduate students also may continue to exempt the value of reduced tuition from their income.
- Elimination of the interest deduction on home equity loans.
- Repeal of the Affordable Care Act's individual mandate.
- An allowance for medical expense deductions in excess of 7.5 percent of Adjusted Gross Income ("AGI") for 2017 and 2018 (then returning to those in excess of 10 percent).
- Retention of the estate tax, with a doubling of the estate tax exemption thresholds to approximately \$11 million and \$22 million, with continued inflation indexing after Dec. 1, 2019 (but reverting to pre-Act law after 2025).
- Retention of the current law's gain recognition rules for sales of securities allowing investors to identify which securities are being sold.
- An increased holding period for long-term capital gains with respect to gains attributable to so-called "carried interest" to three years.

## For businesses:

- A corporate tax rate permanently lowered to 21 percent, effective Jan. 1, 2018.
- A territorial system of taxation for corporations, subject to new base erosion rules, including a base erosion and anti-avoidance tax (BEAT) and foreign minimum tax rules on global intangible low-taxed income (GILTI).
- A deduction for corporations on foreign-derived intangible income (FDII), intended to reduce the effective tax rate on certain income from export transactions.
- A one-time repatriation tax on corporate earnings held overseas, applying different rates to liquid assets (15.5 percent) and illiquid assets (8 percent), and payable over eight years in back-loaded installments.

- Repeal of the corporate alternative minimum tax (AMT) and the Section 199

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Elimination of net operating loss (NOL) deductions to 80 percent of taxable income for losses incurred after 2017.

- Allowance of current deductions for the cost of new investments in qualified depreciable tangible assets (including used property new to a taxpayer) acquired and generally placed in service between Sept. 27, 2017, and Jan. 1, 2023 (with a phasedown for property placed in service in years subsequent to 2022 and before Jan. 1, 2028).
- A new timing rule that accelerates the inclusion of items of income for certain accrual-method taxpayers to when the income is taken into account for financial statement purposes. The rule would not apply to items subject to a special method of accounting (such as the installment method) but would apply to original issue discount.
- An increase to \$1 million in Section 179 expensing for smaller businesses.
- Repeal of certain exceptions to the current Section 162(m) limitations on executive compensation, and imposition of a new excise tax on certain excess compensation received by executives of tax-exempt organizations.
- Elimination of deductions for certain entertainment expenses but retention of the 50 percent deduction for food and beverages through 2025.
- Retention of the low-income housing tax credit and new markets tax credits.
- Modification of the 20 percent historic rehabilitation tax credit, requiring that the allowable credit be taken ratably over five years.
- A 20 percent deduction (reducing the maximum marginal rate to 29.6 percent) on certain pass-through domestic-sourced (including from Puerto Rico) business income from sole proprietorships, partnerships and Subchapter S corporations and from qualified REIT or cooperative dividends. Estates and trusts also are eligible to claim the deduction. Noncorporate taxpayers are not permitted to deduct business losses in excess of business income plus \$500,000 (for joint return filers).
- Repeal of the like-kind exchange rules, except for real property.

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income housing credit and new markets credits and provides that the 20 percent historic rehabilitation credit be taken ratably over five years. Other benefits such as the domestic manufacturing deduction are repealed in favor of a lower rate. The corporate AMT is repealed in an effort to simplify the tax law.

### **A territorial corporate tax system**

A key component of corporate tax reform is moving to a territorial tax system. The territorial approach exempts certain foreign active business income by providing a 100 percent deduction to U.S. corporations (but not U.S. individuals) for dividends received from foreign subsidiaries in which the U.S. corporations own at least 10 percent. The territorial proposal allows such future offshore earnings to be repatriated to the U.S. without additional tax, which allows U.S.-based corporations ready access to their foreign cash. The Act also contains a number of base-erosion measures. The current Subpart F rules applicable to passive and readily movable foreign income generally remain in place (subject to some modifications, such as the repeal of the foreign base company oil-related income rules). The rules causing a foreign corporation's investment in U.S. property to be deemed a Subpart F inclusion (i.e., Section 956) are retained.

Deemed-paid foreign tax credits are permitted only with respect to Subpart F inclusions (not dividends eligible for the territorial regime). Also, income from inventory produced in the U.S. and sold abroad is no longer eligible for split sourcing but must be fully U.S.-sourced.

The lower corporate tax rate combined with moving to a territorial system better aligns the U.S. tax system with the majority of tax systems throughout the developed world. The changes are intended to eliminate both the competitive disadvantage created by our current worldwide system and the incentive for U.S. companies to invert.



The measures to help prevent base erosion may be prudent from the perspective of

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reinvested earnings held in illiquid assets at 8 percent. The deemed inclusion applies to the larger of earnings and profits as of Nov. 2, 2017, or Dec. 31, 2017. The mechanics involve a deemed inclusion at the relevant year-end (irrespective of whether cash is actually repatriated), with a dividends-received deduction to reduce the taxable income sufficient to result in the 15.5 percent or 8 percent rate, as the case may be. A proportionate foreign tax credit is permitted for foreign taxes paid or, in the case of U.S. corporate shareholders, deemed paid on the deemed repatriated earnings. The Act allows the repatriation tax to be paid in back-loaded installments over an eight-year period. Taxpayers may elect to preserve NOLs and thereby coordinate the interaction of NOLs, foreign tax credit carryforwards and other tax attributes.

### **Increased deductions of certain capital expenses to stimulate growth**

The Act also provides for an increased allowance of current deductions for certain capital expenses. It proposes to allow businesses an immediate deduction for the cost of new investments in certain depreciable assets (i.e., not structures or land) acquired and placed in service after Sept. 27, 2017, and before Jan. 1, 2023 (with a phasedown for property placed in service in years subsequent to 2022 and before Jan. 1, 2028). However, rules that allow tax-free like-kind exchanges, except for real-property exchanges, are repealed.

### **Interest deductibility limitations**

The Act limits a large business's deduction for interest expense to the total of interest income plus 30 percent of the business's "adjusted taxable income" (roughly, EBITDA), but it adds back amortization and depreciation for tax years through 2021. Beginning in 2022, depreciation, amortization and depletion are not added back for purposes of computing the 30 percent cap, resulting in a more strict limitation. The Act repeals the existing Section 163(j) anti-earnings-stripping rules.

Taxpayers may carry forward indefinitely any interest deduction not allowed in any

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been proposed by the House and the Senate. This omission is very beneficial to many taxpayers.

### **Prevention of base erosion**

The Act imposes a foreign minimum tax, requiring an inclusion of GILTI earned through controlled foreign corporations. Conceptually, GILTI is income deemed attributable to intangible property (supernormal returns). A U.S. corporate shareholder (but not a U.S. individual) is allowed a 50 percent deduction for GILTI (decreased to 37.5 percent beginning in 2026), reducing the effective tax rate to 10.5 percent (13.125 percent beginning in 2026). A U.S. corporate shareholder (but not a U.S. individual) also is allowed an 80 percent deemed-paid foreign tax credit (separately basketed and which cannot be carried back or forward), meaning that if the GILTI is subject to a 13.125 percent foreign effective tax rate, it generally is not subject to U.S. tax.

The Act also allows a deduction of 37.5 percent of FDII (reduced to 21.875 percent in 2026) for a U.S. corporate shareholder (but not a U.S. individual), limiting the disparate treatment of U.S. corporations that operate through foreign subsidiaries (earning GILTI) and those that export directly from the United States (earning FDII). FDII, like GILTI, is calculated formulaically and is intended to equal the export income attributable to intangible property. The deduction generally reduces the effective tax rate on FDII to 13.125 percent (increased to 16.406 percent in 2026). Notably, the Act does not include the Senate proposal that would have reduced tax costs of repatriating intangible property back to the U.S.

The Act also contains a BEAT intended to impose a 10 percent minimum tax (rising to 12.5 percent in 2026). The minimum tax would effectively apply to multinational groups by partially disallowing deductions to U.S. corporations relating to payments to foreign affiliates. The BEAT generally would apply to deductible payments and

payments for depreciable or amortizable property but, importantly, generally would

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income. Salaries paid to owners are not eligible for the deduction. To prevent owners of pass-through businesses from combining capital-intensive businesses with certain service-related businesses to qualify for the deduction, the Act provides a limitation in the form of an income cap that must be computed for each line of business.

Specifically, the Act provides a deduction of 20 percent of a pass-through entity's domestic-sourced (including from Puerto Rico) qualifying business income (QBI) (including QBI earned by trusts, estates or individuals). QBI generally excludes income from specified service trades or businesses and amounts treated as reasonable compensation by an S corporation or guaranteed payments by partnerships. The deduction is limited to the greater of: (i) 50 percent of the taxpayer's share of the W-2 wages paid by the pass-through entity; or (ii) 25 percent of the taxpayer's share of the W-2 wages paid by the pass through entity, plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property (generally, tangible depreciable property used in the production of business income which has not been fully depreciated prior to the close of the taxable year). This limitation does not apply to joint filers with taxable income of \$315,000 (\$157,000 for individual filers) or less and is phased in between \$315,000 and \$415,000 (\$207,500 for individual filers). The deduction is not available for business income from certain professional service businesses. The statutory definition of a "specified service trade or business" is "any trade or business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities." However, denial of the deduction for such income does not apply to joint filers with taxable income of \$315,000 (\$157,000 for individual filers) or less and is phased in between \$315,000 and



\$415,000 (\$207,500 for individual filers). Taxable income of above \$415,000 for joint

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accumulated adjustments account (amounts already passed through and taxed but not yet distributed) and from its earnings and profits (taxable as dividends) on a pro rata basis.

### **Carried interest holding period**

The Act increases to three years the holding period required for long-term capital gain treatment with respect to partnership interests held in connection with the performance of services. This would include carried interest, or the portion of an investment fund's profit paid to investment managers. This increased holding period appears to apply to both gain recognized upon a sale of the partnership interest by the taxpayer and gain allocated to the taxpayer from a sale of assets by the entity. Therefore, an affected partner would be required to hold his or her partnership interest for at least three years to obtain long-term capital gain treatment on the sale of such interest. In addition, affected partners who received allocations of capital gain in connection with a sale of assets by the partnership would be entitled to long-term treatment only if the partnership held the assets for at least three years prior to sale.

The new holding period rules would apply to partnership interests received (or held) by noncorporate taxpayers in connection with the performance of substantial services in connection with certain industries. The applicable industries include any trade or business related to (i) raising or returning capital or (ii) investing in (or disposing of) or developing specified assets, including securities, commodities, certain real estate, and cash or cash equivalents.

### **Repeal of technical termination rules**

Under current law, a sale or exchange of 50 percent or more of the total interest in partnership capital or profits within any 12-month period causes a partnership to

terminate. The Act repeals this rule, eliminating the need to file short-period returns

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partnership sold all of its assets at fair market value as of the date of the sale or exchange. Such provisions prospectively overrule the Tax Court's decision in a recent case, *Grecian Magnesite Mining v. Commissioner*, 149 T.C. No. 3 (2017) (holding a foreign company's gain on the redemption of a U.S. partnership interest would not be effectively connected to a U.S. trade or business). Moreover, the Act expands the definition of a substantial built-in loss as it affects transfers of partnership interests.

### **Tax on foreign earnings**

Regarding the deemed repatriation tax on foreign earnings, a specific carve-out for S corporations allow S corporation shareholders to elect to defer their deemed repatriation liabilities until either (i) the shareholder transfers stock in the S corporation or (ii) the S corporation ceases to exist, ceases doing business, liquidates, sells substantially all its assets or terminates its S corporation status. The statute of limitations for assessment is extended to six years for such mandatory inclusions.

### **Contributions to capital**

The Act generally preserves the rule that a corporation's gross income does not include contributions to capital, but the Act requires inclusion in income of any contribution in aid of construction, any contributions by customers or potential customers, and any nonshareholder contribution by a governmental or civic entity.

### **Cash method of accounting**

The Act would expand the availability of the cash method of accounting. Corporations (including S corporations) and partnerships with a corporate partner with annual average gross receipts of \$25 million (presently \$5 million) or less may use the cash method. Additionally, such businesses would have to satisfy the threshold requirement for only a three-prior-taxable-year period rather than for all prior years as required under current law.

Furthermore, a business that does not exceed the \$25 million threshold would be

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## **Executive compensation**

The Act provides that the executive compensation rules under current Section 162(m) would apply to large private C or S corporations in addition to publicly traded entities. The proposal would retain the limitation for a \$1 million-per-year corporate deduction for compensation paid or accrued regarding a “covered employee” but would eliminate certain exceptions.

Specifically, such corporations would no longer be permitted to deduct amounts in excess of \$1 million for commissions or other performance-based compensation. Moreover, the proposed rules would revise the definition of “covered employee” to include the CEO, the CFO and the three other highest-paid employees rather than the CEO and the four most highly compensated officers. Further, an individual would be a covered employee if the individual is the CEO or CFO at any time during the year, and covered employees would remain covered employees for all future years. The Act provides a transition rule excluding from the proposed changes any remuneration paid pursuant to a written binding contract with any specific covered employee in effect on Nov. 2, 2017, that is not subsequently modified in any material respect.

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