

December 20, 2017

Congress Sends Tax Reform Bill to President for Signature

On Wednesday, December 20, 2017, the House of Representatives voted to pass the most significant tax reform legislation in three decades (the “Act”) just hours after the Senate passed the measure. The legislation’s provisions will affect a broad range of taxpayers, making substantial changes to the taxation of businesses, individuals, and tax-exempt organizations, and adding significant complexity to the international tax regime. The Act will now be sent to President Trump’s desk, and it is expected that he will sign the bill into law.

Although substantive changes were made to the legislation during the course of the legislative process, including last-minute deals struck with key legislators, the Act maintains the tax reform framework that was established by the President and Congressional Republicans earlier this year, including lowering business tax rates, limiting the deductibility of interest expense, providing for immediate capital expensing, imposing broad-based changes to the international tax regime (including a one-time mandatory repatriation of deferred foreign earnings), and streamlining taxation of individuals.

Key provisions of the Act are outlined below. A more detailed description of the legislation, including a comparison to the House and Senate bills, can be found [here](#). Our previous coverage of tax reform can be found on our [Capital Insights](#) page.

Except as otherwise noted, the Act is effective for taxable years beginning after 2017.

Business Taxes

- **Reduction of Corporate Income Tax Rate.** The Act reduces the maximum corporate tax rate to 21%, and repeals the corporate AMT.
- **Cap on Deductions for Business Interest.** Corporations and other business taxpayers will be barred from deducting net business interest expense in excess of approximately 30% of EBITDA in the case of tax years beginning before 2022, and, in the case of tax years thereafter, approximately 30% of EBIT. This rule will not apply to businesses with average gross receipts of \$25 million or less, real estate businesses, certain utilities businesses, or the trade or business of performing services as an employee. Taxpayers will be permitted to carry forward disallowed interest deductions indefinitely.
- **Cap on Use of NOLs.** The Act caps the use of net operating loss carryforwards at 80% of taxable income. NOL carrybacks will be phased out.
- **Accelerated Expensing of Tangible Personal Property.** Corporations and other business taxpayers will be entitled to expense 100% of the cost of tangible depreciable personal property acquired and placed in service after September 27, 2017 and before January 1, 2023. Expensing will be phased out for such property placed in service after December 31, 2022. Expensing will not be available for real estate, most intangible property, and property of real estate businesses and regulated public utilities.
- **Expansion of Cash Method of Accounting.** The ceiling for corporations permitted to use the cash method of accounting is increased from \$5 million to \$25 million in average yearly gross receipts, with automatic yearly adjustments for inflation. Any business with gross receipts below the ceiling will be entitled to use the cash method, regardless of whether the business owns inventory.

- **Repeal of Deduction for Domestic Production Activities.** Under current law, a taxpayer is generally entitled to a deduction equal to 9% of the lesser of the taxpayer's qualified production activities income or the taxpayer's taxable income for the tax year. The Act repeals this deduction.
- **Repeal of Deduction for Entertainment Expenses.** The Act disallows deductions for entertainment, amusement, or recreation activities. Deductions for transportation fringe benefits and on-premises gyms and amenities provided to employees that are not directly related to the employer's trade or business will be allowed only to the extent such benefits are included in the employee's taxable compensation.

Pass-through and Direct Business Income Taxes

- **Lower Taxes on Certain Pass-through and Direct Business Income.** The Act allows individuals to deduct 20% of their "qualified business income" (excluding compensation and investment income) earned directly or from certain pass-through entities, subject to certain restrictions.
- **Carried Interest.** Carried interests in investment partnerships (including private equity, real estate and venture capital funds) will be eligible for long-term capital gains treatment only after satisfying a three-year holding period requirement.

International Taxation

- **Modified Territorial Tax Regime.** The Act implements a modified territorial tax regime that generally provides a 100% exemption for dividends received by U.S. corporate shareholders that own 10% or more of the voting stock of non-U.S. corporations. The Act denies the exemption for certain hybrid dividends where the payor can deduct the dividend or realize a similar benefit with respect to income taxes imposed outside of the United States.
- **Modifications to CFC Rules.**
 - The existing "Subpart F" regime of taxing, on a current basis, U.S. shareholders of controlled foreign corporations ("CFCs") on such corporations' passive earnings will be retained. However, the Act expands the Subpart F regime to subject, on a current basis, certain U.S. shareholders of CFCs to a minimum tax on their global intangible low tax income ("GILTI"), which generally equals the active business income of the CFC in excess of a "normal" return, defined as a deemed rate of return on the adjusted tax basis of the CFC's depreciable tangible assets. The Act subjects the GILTI of U.S. individual shareholders, including those who own through domestic funds, to tax at marginal federal income tax rates (e.g., maximum of 37%, plus 3.8% net investment income tax), and the GILTI of domestic corporations to a minimum tax rate of 10.5%. Where non-U.S. taxes are creditable, the combined U.S. and foreign tax burden for a domestic corporation will not exceed 13.125%.
 - The Act also modifies relevant ownership rules to broaden the class of foreign corporations that qualify as CFCs. In particular, the Act makes "downward attribution" of stock ownership effective starting with the last tax year of a foreign corporation beginning *before* 2018. The Act also broadens the U.S. shareholder definition to include a U.S. person that owns 10% or more of the total shares of a foreign corporation by value (where the current definition only looks to *vote*).
- **Repatriation.** In connection with the transition to the new international regime, certain 10% or greater U.S. shareholders of a foreign corporation will be subject to a one-time mandatory repatriation tax on the retained foreign earnings of the corporation. Retained foreign earnings will be subject to tax at a rate of 15.5% to the extent of the foreign corporation's cash or cash equivalent holdings. Retained foreign earnings in excess of

cash and cash equivalents will be subject to tax at a rate of 8%. Modestly higher effective rates will be applicable to U.S. individual shareholders, including those holding interests through partnerships, unless such shareholders elect to be taxed at corporate rates on all amounts included in income under the Subpart F regime for the taxable year. The tax will be calculated for the last tax year of the corporation beginning before 2018, but taxpayers will be allowed to elect to pay this tax in installments over eight years.

- **Base Erosion Minimum Tax.** The Act imposes a 10% minimum tax on a corporation's taxable income calculated without regard to most deductible payments to related foreign persons, certain derivative payments, and certain other amounts. The tax will be phased in, with a 5% minimum tax rate applicable for tax years beginning in 2018.
- **Hybrid Payments.** The Act denies a deduction on certain interest and royalty payments made to a related party that does not have corresponding taxable income (or is afforded a deduction) in its country of residence.
- **Reduced Tax Rates for Exporters.** The Act reduces tax rates for U.S. corporations with "foreign-derived intangible income" from exporting goods or services to as low as 13.125%.
- **Transfers to Foreign Corporations.** The Act eliminates the "active trade or business exception" that previously permitted tax-free exchanges of property used in a business conducted outside of the U.S., notwithstanding the fact that the transfer was to a foreign corporation. Goodwill, workforce in place, and going concern value are included within the definition of "intangible property" subject to special rules when transferred by a U.S. person to a foreign corporation.

Tax-Exempt Organizations

- **New Excise Tax on Private College and University Endowments.** Private colleges and universities with at least 500 full-time equivalent students and investment assets with a value of at least \$500,000 per student will be subject to an excise tax of 1.4% on their net investment income.
- **Excise Tax on Tax-Exempt Organization Executive Compensation.** A tax-exempt organization will be subject to a new excise tax equal to 21% of the remuneration in excess of \$1 million paid to any employee that is (or in a prior year beginning after 2016 was) among its five highest paid employees, plus 21% of any "excess parachute payments" – generally speaking, severance or severance-type compensation equal to or in excess of three times the employee's average annual compensation over a specified look-back period. The Act exempts amounts paid to licensed medical professionals in exchange for medical or veterinary services.
- **Computation of UBTI.** Tax-exempt organizations will be required to compute unrelated business taxable income separately for each separate unrelated trade or business.
- **Interest on Advanced Refunding Bonds No Longer Tax-Exempt.** The Act repeals the exclusion from gross income for interest on advance refunding bonds.
- **Deduction for Amounts Paid for College/ University Athletic Seating Rights.** The Act eliminates the special charitable deduction in connection with the right to purchase seating at athletic events.

Executive Compensation

- **Limited Public Company Executive Compensation Deductions.** Under current law, the deduction available to a publicly traded corporation for compensation paid in any year to its CEO or to any of the corporation's other three most highly compensated officers other than its CFO is limited to \$1 million. A number of exemptions and coverage limitations currently diminish the practical effect of this limitation. Among other changes, the Act eliminates the performance-based compensation exemption, and expands the limitation to include a company's CFO and any employee who had been a covered employee in a prior year beginning after 2016. It also extends the limitation to certain debt and equity issuers that are required to make public filings. The Act provides a grandfathering rule for compensation paid under a written binding contract in effect on November 2, 2017.

Individuals

- **Reduction of Income Tax Brackets.** Individual income tax brackets under the Act will be as follows: 10%, 12%, 22%, 24%, 32%, 35% and 37%, with the top rate applying to taxable income over \$600,000 for married individuals filing jointly (\$500,000 for unmarried individuals). This provision sunsets after 2025. Three brackets will remain for capital gains: 0%, 15% and 20%.
- **Alternative Minimum Tax.** The Act retains the Individual AMT, but increases (i) the exemption amount to \$109,400 for married individuals filing jointly (\$54,700 for unmarried individuals) and (ii) the phase-out thresholds to \$1,000,000 for married individuals filing jointly (\$500,000 for unmarried individuals). This provision sunsets after 2025.
- **Standard Deduction and Repeal of Personal Exemption.** The standard deduction will be increased to \$24,000 for married individuals filing jointly (\$12,000 for unmarried individuals), adjusted for inflation. The Act repeals the deduction for personal exemptions (currently \$4,050 per person). These provisions sunset after 2025.
- **State and Local Taxes.** Taxpayers will be able to deduct up to \$10,000 for state and local property and income taxes. The \$10,000 limit will not apply to state and local taxes that are paid or accrued in carrying on a trade or business. This provision sunsets after 2025.
- **Mortgage Interest Deduction.** Under current law, taxpayers are allowed to deduct interest payments on up to \$1 million of mortgage debt on a principal residence. The Act decreases the limit to \$750,000 for mortgage debt incurred after December 15, 2017. This provision sunsets after 2025.
- **Child Tax Credit.** The child tax credit is increased to \$2,000 per qualifying child (refundable up to \$1,400). Taxpayers will receive additional non-refundable \$500 credits for each non-child dependent. The credits will phase out on income over \$400,000 for married individuals filing jointly (\$200,000 for unmarried individuals). Taxpayers will be required to provide a social security number for each qualifying child. This provision sunsets after 2025.
- **Repeal of ACA Individual Mandate.** The Act repeals the individual shared responsibility provisions of the Affordable Care Act, commonly known as the "individual mandate."
- **Estate Taxes.** The exclusion amount for gift and estate taxes and the generation-skipping transfer tax through 2025 is doubled to \$10 million. Current law exclusion levels will be restored for tax years starting in 2026. The basis step-up at death is preserved.