



Tax Reform – KPMG Report on New Tax Law

Analysis and observations

February 6, 2018

kpmg.com





Introduction

On December 22, 2017, the president signed into law H.R. 1, originally known as the Tax Cuts and Jobs Act. The new law (Public Law No. 115-97) represents the culmination of a lengthy process in pursuit of business tax reform over the course of more than 20 years.

The legislation includes substantial changes to the taxation of individuals, businesses in all industries, multinational enterprises, and others. Overall, it provides a net tax reduction of approximately \$1.456 trillion over the 10-year “budget window” (according to estimates provided by the Joint Committee on Taxation (JCT) that do not take into account macroeconomic/dynamic effects).

Highlights include:



A permanent reduction in the statutory C corporation tax rate to 21%, repeal of the corporate alternative minimum tax (AMT), modifications to the rules for expensing capital investment, limitation of the deduction for interest expense, and a multitude of other changes to the corporate tax rules



Fundamental changes to the taxation of multinational entities, including a shift from a system of worldwide taxation with deferral to a hybrid territorial system, featuring a participation exemption regime with current taxation of certain foreign income, a minimum tax on low-taxed foreign earnings, and new measures to deter base erosion and promote U.S. production



Significant changes relevant to the taxation of tax-exempt organizations, insurance businesses, financial institutions, regulated investment companies (RICs), and real estate investment trusts (REITs)



A temporary new deduction for certain individuals, trusts, and estates with respect to “domestic qualified business income” of passthrough entities and sole proprietorships



Temporary reductions in the individual income tax rates, accompanied by new limits on itemized deductions (such as the deduction for state and local taxes), other temporary changes to the individual income tax rules, and a more restrictive permanent cost-of-living bracket adjustment



Permanent repeal, in effect, of the individual mandate in the Patient Protection and Affordable Care Act.

This report includes analysis and observations regarding the myriad tax law changes in H.R. 1. This report also includes discussions of (1) the impact of the new law on various industries (including RICs, REITs, insurance, natural resources, and financial services); (2) potential state and local tax implications of the law changes; and (3) financial accounting considerations.

This report is based on the new law as enacted on December 22, 2017. Although parts of the report may reference some developments that occurred between enactment and the date this report “went to press” on January 15, 2018, this report does not reflect all developments after enactment, including possible administrative guidance, judicial decisions, or future legislative developments. To read KPMG’s reports and coverage of subsequent developments, see [TaxNewsFlash-Tax Reform](#) and [TaxNewsFlash-United States](#).

This is one of a series of reports that KPMG prepared as tax reform moved through various stages of the legislative process.

Throughout this report, links to background and resource documents appear in blue type. If you are using a hard copy of this report, visit www.kpmg.com/us/new-tax-law-book for a list of live links to these materials.

Contents

Executive summary	
Recent milestones	8
Impact of reconciliation rules on size and substance	10
Technical highlights	10
Effective dates and temporary provisions	15
In general	15
Effective dates for fiscal year filers – Code section 15	16
Possible need for subsequent clarifications	17
Practical considerations	18
Documents	19

Individuals	
Ordinary income tax rates – in general	21
New indexing method	23
Filing status, standard deductions, and personal exemptions	23
Reform of the child tax and qualifying dependents credits	24
Treatment of business income and losses of individuals	25
Tax rates on capital gains and dividends	25
Suspension and reform of certain itemized deductions and income exclusions	25
Deduction for taxes (including state and local taxes) not paid or accrued in a trade or business	26
Suspend and modify deduction for home mortgage interest and home equity debt	26
Increased percentage limitation for certain charitable contributions	27
Modify deduction for personal casualty and theft losses	27
Suspension of miscellaneous itemized deductions subject to the 2% floor	28
Suspension of overall limitation on itemized deductions (“Pease” limitation)	28
Suspension of exclusion for qualified bicycle commuting reimbursement	28
Suspension of exclusion for qualified moving expense reimbursements	28
Suspension of deduction for moving expenses	29
Modification to the limitation on wagering losses	29
Modification to individual AMT	30
Estate, gift, and generation-skipping transfer tax	30

Other	31
Temporary reduction in medical expense deduction floor	31
Allow increased contributions to ABLE accounts, and allow contributions to be eligible for saver's credit	31
Rollovers between qualified tuition programs and qualified ABLE programs	31
Combat zone tax benefits to Armed Forces in Sinai Peninsula of Egypt	32
Exclude income from the discharge of student debt	32
Modification of education savings rules (529 plans)	32
Relief for 2016 disaster areas	32
Repeal of deduction for alimony payments and corresponding inclusion in gross income	33
Eliminate deduction for member of Congress living expenses	33
Excluded House and Senate proposals	33
<hr/>	
Affordable Care Act – Healthcare	
Reduce Affordable Care Act individual shared responsibility payment to zero	37
<hr/>	
Business – In general	
Reductions in corporate tax rate and dividends received deduction	38
Corporate AMT	40
Modified net operating loss deduction	41
Revisions to treatment of capital contributions	43
Cost recovery	44
Modification of rules for expensing depreciable business assets	44
Temporary 100% expensing for certain business assets	44
Requirement to capitalize section 174 research and experimental expenditures	46
Modifications to depreciation limitations on luxury automobiles and personal use property	46
Modifications of treatment of certain farm property	47
Applicable recovery period for real property	47
Expensing certain citrus replanting costs	48
Business-related deductions, exclusions, etc.	48
Limitation on the deduction of net business interest expense	48
Repeal deduction for income attributable to domestic production activities	52
Modify tax treatment of certain self-created property	52
Repeal of rollover of publicly traded securities gain into specialized small business investment companies	53
Limits on like-kind exchange rules	53
Limitation of deduction by employers of expenses for entertainment and certain fringe benefits	54

Unrelated business taxable income increased by amount of certain fringe benefit expenses for which deduction is disallowed	55
Repeal of deduction for local lobbying activities	55
Deny deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment or sexual abuse	55
Accounting methods	56
Certain special rules for tax year of inclusion	56
Small business accounting	58
Business credits	60
Modification of credit for clinical testing expenses for certain drugs for rare diseases or conditions	60
Modification of rehabilitation credit	60
Employer credit for paid family and medical leave	60
Miscellaneous business provisions	61
Qualified opportunity zones	61
Alaskan Native Corporation payments and contributions to settlement trusts	62
Aircraft management services	62
Expand nondeductibility of certain fines and penalties	63
<hr/>	
Compensation	
Modification of limitation on excessive employee remuneration	65
Treatment of qualified equity grants	66
Excise tax on excess tax-exempt organization executive compensation	68
<hr/>	
Retirement savings	
Repeal of special rule permitting recharacterization of IRA contributions	71
Extended rollover period for the rollover of plan loan offset amounts	71
Modification of rules for length of service award plans	71
<hr/>	
Passthrough entities and sole proprietorships	
Treatment of business income and loss of certain noncorporate taxpayers	73
Deduction of 20% for certain passthrough income (subject to sunset)	73
Loss limitation rules for taxpayers other than C corporations (subject to sunset)	76
Tax gain on the sale of a partnership interest on look-through basis	76
Modification of the definition of substantial built-in loss in the case of transfer of partnership interest	79
Partnership charitable contributions and foreign taxes taken into account in determining partner loss limitation under section 704(d)	80
Short-term capital gain with respect to applicable partnership interests	80

Repeal of partnership technical termination rules	83
Provisions applicable to “eligible terminated S corporations”	83
Changes relating to electing small business trusts	85
<hr/>	
Banks and financial institutions	
Deduction limits for FDIC premiums	87
<hr/>	
Bonds	
Repeal of tax credit bonds	89
Repeal of advance refunding bonds	90
<hr/>	
Insurance	
Net operations loss deductions of life insurance companies	93
Net operations loss deductions of property and casualty insurance companies	94
Repeal small life insurance company deduction	94
Repeal Code section 807(f) spread—Adjustment for change in computing reserves	95
Repeal special rule for distributions to shareholders from pre-1984 policyholders surplus accounts	95
Modify proration rules for property and casualty insurance companies	96
Repeal elective deduction and related special estimated tax payment rules	96
Computation of life insurance tax reserves	97
Modify rules for life insurance proration for purposes of determining the dividends received deduction	98
Capitalize certain policy acquisition expenses (DAC)	98
Tax reporting for life settlement transactions, clarification of tax basis of life insurance contracts, and exception to transfer for valuable consideration rules	99
Modify discounting rules for property and casualty insurance companies	101
<hr/>	
Exempt organizations	
Unrelated business taxable income separately computed for each trade or business activity	103
Excise tax based on investment income of private colleges and universities	104
Repeal of deduction for amounts paid in exchange for college athletic event seating rights	104
Repeal of substantiation exception in case of contributions reported by donee	104

International	
Establishment of participation exemption system for taxation of foreign income	108
Add U.S. participation exemption	108
Add special rules relating to sales or transfers involving specified 10% owned foreign corporations	109
Mandatory repatriation	110
Rules related to passive and mobile income	116
Current-year inclusion of global intangible low-taxed income by United States shareholders	116
Add deduction for foreign-derived intangible income	121
Other modifications of subpart F provisions	122
Eliminate inclusion of foreign base company oil-related income	122
Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment	122
Modification of stock attribution rules for determining status as a controlled foreign corporation	122
Modification of definition of U.S. shareholder	123
Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply	123
Prevention of base erosion	124
Adds limitations on income shifting through intangible property transfers	124
Limit deduction of certain related-party amounts paid or accrued in hybrid transactions or with hybrid entities	124
Surrogate foreign corporations not eligible for reduced rate on dividends	126
Modifications related to foreign tax credit system	126
Repeal section 902 indirect foreign tax credits; determination of section 960 credit on a current-year basis	126
Separate foreign tax credit limitation basket for foreign branch income	127
Determine source of income from sales of inventory solely on basis of production activities	127
Amend section 904(g) to allow increased overall domestic loss recapture	128
Limit foreign tax credits for global intangible low-taxed income	128
Inbound provisions	128
Add base erosion and anti-abuse tax (BEAT)	128
Other provisions	132
Modify insurance exception to the passive foreign investment company rules	132
Repeal fair market value method of interest expense apportionment	133
Modify Code section 4985 excise tax	133

Procedural provisions	
Extension of time limit for contesting IRS levy	135
CRAFT beverages	
Exempt the aging period of beer, wine and spirits from UNICAP rules related to interest	137
Reduced rate of excise tax on beer	138
Transfers of beer in bond	138
Reduced rate of tax on certain wine	139
Adjust alcohol content level of wine for application of excise taxes	139
Reduced rate of tax on mead and certain carbonated wines	140
Reduced excise tax rates on distilled spirits	140
Allow transfer of bonded spirits in bottles	141
REITs	143
RICs	149
Natural resources	153
State and local tax implications	157
Impact of tax reform on accounting for income taxes	169
Appendices	
Appendix A: JCX-67-17 (Conventional revenue estimate)	175
Appendix B: JCX-68-17 (Distributional effects)	185
Appendix C: JCX-69-17 (Macroeconomic analysis)	192
Appendix D: KPMG List of new or revised procedural items in the new tax law	206
KPMG contacts	214

Executive summary

This summary provides a high-level overview of the recent history of the new law, some of the major changes made by the law, the possible need for subsequent corrective legislation, effective dates, and other issues.



Recent milestones

The new law represents the culmination of a long process in pursuit of business tax reform. Over the course of several administrations since the enactment of the Tax Reform Act of 1986, there have been many fits and starts towards tax reform.

The current effort began in earnest with the June 2016 release of the [House GOP “Blueprint”](#) on tax reform. While the Blueprint never progressed beyond conceptual form, it began to build Republican consensus for major revisions to the tax code centered on reduction of the corporate tax rate and reform of the system governing taxation of international business income. A number of the Blueprint’s concepts are incorporated in the new law. Momentum for this concept of tax reform increased with the November 2016 election of Donald Trump as president and continued GOP majorities in the House and Senate. Tax reform, a major Republican campaign issue, became a top agenda item for the 115th Congress.

Still, most of 2017 saw little visible progress made on tax reform (although work continued behind the scenes), as the Republican-controlled Congress chose to focus on healthcare issues instead. When healthcare legislation efforts failed late in the summer, Congressional Republicans moved tax reform to the “front burner.”

On September 27, the so-called “Big Six” Republican tax reform principals released their 9-page [Unified Framework on Tax Reform](#) (the “Framework”). The Framework identified the broad areas of policy agreement between the House, Senate, and Administration. House and Senate Republicans began to work separately on tax bills consistent with the Framework.

As illustrated (see Figure 1), developments accelerated dramatically in November, when the process began to move at a pace that may well be unprecedented given the size and scope of the law changes.

On November 2, Ways and Means Chairman Kevin Brady released his legislative proposal, H.R. 1, the Tax Cuts and Jobs Act. H.R. 1 was then referred to the Ways and Means Committee, where it was amended several times and favorably reported out of committee on November 9. The bill was then approved by the full House on November 16, with no Democratic support. (Read: [KPMG’s description and analysis of the House-passed bill](#)).

Meanwhile, the Senate began action on November 9, when Chairman of the Senate Finance Committee Orrin Hatch (R-UT) released his “Chairman’s mark” of proposed tax reform legislation. The Senate Finance Committee made amendments to the Chairman’s mark before favorably reporting the bill on November 16. The Senate Finance Committee bill then was considered by the

full Senate, which narrowly passed it after further amendment, 51-49, with no Democratic support, on December 2. (Read: [KPMG’s description and analysis of the Senate-passed bill](#)).

A joint House-Senate conference committee reconciled the differences between the House-passed and the Senate-passed versions of H.R. 1 and produced a conference agreement. On December 15, the conference committee approved the report of its agreement on H.R. 1, the tax reform bill. The conference report was a compromise bill, blending elements of both the previously passed House and Senate versions of the bill. The conference report was approved by all Republican conferees, but was not approved by any Democratic conferees.

On December 19, the House passed the conference agreement by a vote of 227 to 203. Only 12 Republicans voted against the bill, while no Democrats voted for the bill.

Later that same day, the Senate parliamentarian determined that three provisions violated budget reconciliation rules that were being used to move the legislation through the Senate with fewer than 60 votes. Ultimately, these measures were

stricken from the bill in the early morning of December 20. The stricken provisions related to the following:

- A provision related to the ability to use section 529 distributions for home schooling expenses
- A “tuition-paying” requirement in determining whether an institution meets the 500-student threshold for the excise tax on endowments of certain private colleges and universities
- The descriptive title of the bill (i.e., the name “the Tax Cuts and Jobs Act”)

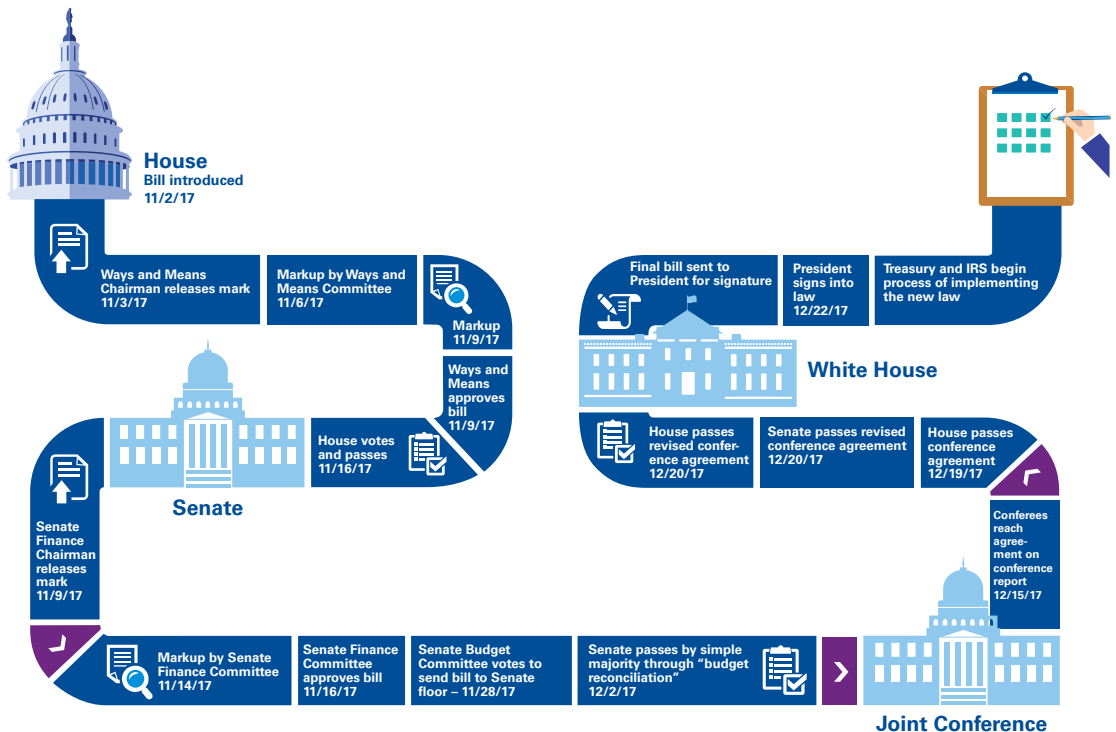
Read KPMG’s [Conference Agreement for H.R. 1 – Initial Observations](#)

The Senate passed the modified legislation by a vote of 51-48, with all Republicans present voting for it and all Democrats voting against it. Because the House and the Senate must pass identical versions of legislation before such legislation is transmitted to the president, the Senate version was returned to the House.

The House considered the legislation shortly after noon on December 20, approving it by a vote of 224-201. No Democrats voted in favor of the legislation.

President Trump signed the legislation into law on December 22.

Figure 1 – Path to Enactment



Decisions to include sunset dates for most of the individual tax changes and the passthrough deduction presumably were at least partially related to the need to fulfill the reconciliation-imposed rules regarding long-term deficits.

Importantly, as discussed above, several provisions of the conference agreement were stricken during Senate consideration after the Senate parliamentarian concluded they ran afoul of budget reconciliation requirements.



Impact of reconciliation rules on size and substance

The new law moved through the Congress using special budget reconciliation procedures. The use of these procedures affected the size and substance of the new law.

Budget reconciliation is a procedure by which spending and revenue legislation (including tax measures) can avoid a potential Senate filibuster and be passed by a simple majority vote in the Senate. The ability to use these rules was “unlocked” when the House and Senate agreed to a budget resolution for FY 2018. The budget resolution permitted H.R. 1, as a reconciliation bill, to increase the federal deficit by up to \$1.5 trillion over the 10-year budget window. According to estimates prepared by the JCT, the final version of H.R. 1 met this target — it reflected a net tax cut of \$1.456 trillion over the 10-year window (not taking into account possible macroeconomic growth).

To retain the protection from a Senate filibuster that the reconciliation rules provide, H.R. 1 also needed to meet a number of complex requirements, including that it not increase the long-term deficit of the United States. Even though the FY 2018 budget resolution allowed a net tax cut of up to \$1.5 trillion within the 10-year window, no title of the agreement could result in a net tax cut in any year beyond the 10-year budget window unless offset by an equivalent reduction in spending. The Congressional Budget Office analysis found that the legislation met the requirement.

In addition, under budget reconciliation, each provision generally needed to have a nonincidental revenue effect.

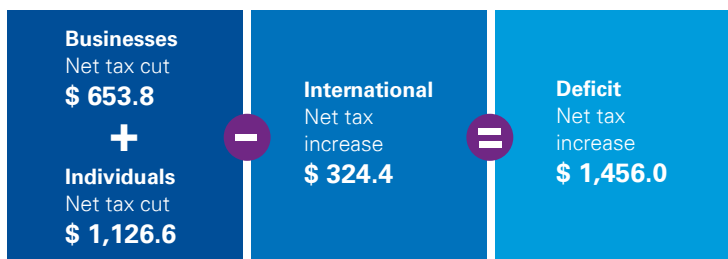


Technical highlights

According to JCT estimates, the new law reflects a net tax cut of approximately \$1.456 trillion over the 10-year budget window. A JCT revenue table (JCX-67-17) shows the revenue effects for various categories of taxpayers, as illustrated in the graphic below. Note that a new deduction for certain owners of flowthrough businesses as well as new loss limitation rules for taxpayers other than C corporations are included in the “individual” category.

The impact of the new law on a particular taxpayer, of course, will turn on the facts and circumstances.

Accounting for Reform (in \$ billions/over 10 years*)



*Estimates based on JCT conventional scores, not taking into account estimated growth in GDP. See JCX-67-17.

Domestic business provisions

The full list of changes for businesses is extensive, including tax benefits as well as tax increases.

Corporate rate and corporate alternative minimum tax

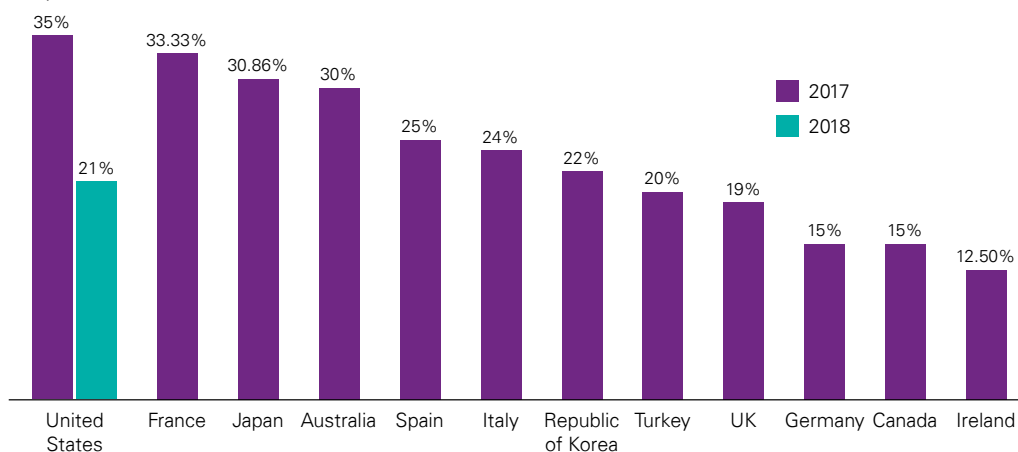
The centerpiece of the new law is the permanent reduction in the corporate income tax rate from 35% to 21%. The rate reduction generally took effect on January 1, 2018. For how rate changes apply to fiscal year corporate filers, see the discussion of Code section 15, below.

As indicated in the chart below, the rate reduction puts the U.S. statutory corporate rate more in the middle of the “pack” of statutory corporate rates levied by central governments of major OECD nations (not including local taxes and surtaxes) — achieving a policy priority of many Republicans.

The new law also repeals the corporate alternative minimum tax (AMT) — a significant change from the Senate version of H.R. 1.

U.S. and other OECD statutory corporate tax rates

Corporate income tax rates* in select OECD countries



*Basic, top corporate income tax rate levied by central government. Local level taxes and surtaxes are not included and can be substantial for some countries (e.g., the 2017 German rate could vary between 22.83-36.83% with local trade tax rates).

Source: KPMG International, Tax Rates Online, 2017 data

Expensing

The new law temporarily makes expensing the principal capital cost recovery regime, increasing the section 168(k) first-year “bonus” depreciation deduction to 100% and allowing taxpayers to write off immediately the cost of acquisitions of plant and equipment. This expensing regime goes further than pre-enactment law bonus depreciation by applying to both new and used property. The 100% bonus depreciation rule applies through 2022, and then ratably phases down over the succeeding five years.

Temporary deduction against business income earned by passthrough entities

The new law permits certain noncorporate owners (i.e., owners who are individuals, trusts, or estates) of certain partnerships, S corporations and sole proprietorships to claim a 20% deduction against qualifying business income. There are numerous limitations on the income eligible for the deduction, with the apparent goal of treating compensation for services as ordinary income that is not eligible for the special deduction. Importantly, the deduction against qualifying income is scheduled to expire for tax years beginning after December 31, 2025.

Revenue-raising provisions

To partially offset the costs of these tax benefits, the new law repeals or modifies a number of Code provisions. For example, the new law:



- Repeals the section 199 domestic manufacturing deduction (beginning in 2018)
- Limits the deductibility of net business interest expense to 30% of adjusted taxable income. The new law starts with a broader definition of adjusted taxable income, but significantly narrows that definition beginning in 2022
- Limits the carryover of net operating losses to 80% of taxable income and eliminates the carryback (with special rules for certain insurance and farming businesses)
- Narrows the scope of the rules relating to contributions to capital (without repealing section 118 as was proposed in the House bill)
- Modifies the deductibility of business entertainment expenses
- Provides significant changes for taxation of the insurance industry
- Requires certain research or experimental (R&E) expenditures to be capitalized beginning in 2022

Letting the numbers do the talking

The JCT's revenue estimates indicate that the following provisions are among the most significant tax cuts and tax increases for businesses in general:

Top business tax increases and tax cuts

(in \$ billions/over 10 years)

Tax increases			Tax cuts		
	Limit interest deduction	\$253.4		21 % corporate rate	-1,348.50
	Limit use of NOLs	\$201.1		20% partnership deduction	-414.5
	Disallow passthrough losses in excess of \$500,000	149.7		Expensing	-86.3
	Amortization of R&E expenditures	\$119.7		Repeal corporate AMT	-40.3
	Repeal of manufacturing deduction	\$98.0		Simplified accounting (small business)	-30.5
	Modify credit for rare condition drugs	\$32.5		Increase small business expensing	-25.9
	Limit like-kind exchanges	\$31		S Corp conversions to C Corps	-6.1

*Estimates based on JCT conventional scores, not taking into account estimated growth in GDP. See JCX-67-17.

Multinational entity taxation

The new law makes fundamental changes to the taxation of multinational entities. In general, the new law shifts the United States from a system of worldwide taxation with deferral to a participation exemption regime with current taxation of certain foreign income. To accomplish this, the new law includes several features, including:

- A 100% deduction for dividends received from 10%-owned foreign corporations
- A minimum tax on "global intangible low-taxed income" (GILTI)

- As a transition to the new regime, deemed repatriation of previously untaxed “old earnings.” A 15.5% rate applies to earnings attributable to liquid assets and an 8% rate applies to earnings attributable to illiquid assets

Furthermore, the new law includes significant additional anti-base erosion measures. Notably, the law includes a Base Erosion Anti-Abuse Tax (BEAT). The BEAT generally imposes a minimum tax on certain deductible payments made to a foreign affiliate, including payments such as royalties and management fees, but excluding cost of goods sold. The BEAT generally applies to certain payments paid or accrued in tax years beginning after December 31, 2017.

The new law includes several other provisions targeted at cross-border transactions, including revised treatment of hybrids, a new special deduction for certain foreign-derived intangible income, and rules for outbound transfers of intangibles.

The new law does not, however, include the House and Senate proposals to add a new section 163(n) to the Code to limit the amount of interest a domestic corporation can deduct to a measure of its proportionate share of the worldwide group’s external indebtedness.

Letting the numbers do the talking

The JCT’s revenue estimates indicate that the following provisions are among the most significant tax cuts and increases for multinational businesses:

Top international tax increases and tax cuts

(in \$ billions/over 10 years)

Tax increases		Tax cuts	
Repatriation	338.8	Participation exemption	-223.6
BEAT	149.6	FDII	-63.8
GILTI	112.4	Foreign oil-related income taxation	-4.0
Reduced tax on CFC sales/transfers	11.8	Increase domestic loss recapture for pre-2018 losses	-2.3

**Estimates based on JCT conventional scores, not taking into account estimated growth in GDP. See JCX-67-17.*

Individual provisions—subject to sunset after 2025

The agreement makes a number of temporary changes to the individual rate structure, as well as to deductions and credits.

The new law retains seven tax brackets but modifies the “breakpoints” for the brackets and reduces the rate for the top bracket to 37%. The temporary new brackets are 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The top rate applies to single filers with income over \$500,000 and married joint filers with income over \$600,000.

The standard deduction is temporarily increased to \$24,000 for joint filers and \$12,000 for individual filers, with these deductions indexed annually. At the same time, the deduction for personal exemptions is repealed, while the child tax credit is enhanced and the phase-out thresholds are substantially increased.

The revenue cost of these changes is offset by temporarily modifying or eliminating a number of tax preferences, many of them significant and long-standing. These include capping the home mortgage interest deduction to interest expenses attributable to mortgage balances no greater than \$750,000 (for mortgages incurred December 15, 2017 or later), eliminating deductions for home equity loan interest, and, most significantly, capping the deduction for state and local taxes at \$10,000. The so-called “Pease” limitation is suspended.

Most of the changes affecting individual taxpayers (including the deduction for certain owners of passthrough businesses) are scheduled to cease to apply after December 31, 2025 and to revert to their pre-2018 form. Future legislation would be required to make the provisions effective beyond 2025.



The 2025 sunset does not apply to the new law's repeal of the Affordable Care Act's individual shared responsibility payment (the individual mandate) or the substitution of a new, lower inflation index for individual rate brackets.

The estate, GST, and gift tax exemption amount is doubled to \$10 million (indexed for inflation) through 2025. The new law does not incorporate a House proposal to repeal the gift and estate tax.

Letting the numbers do the talking

The JCT's revenue estimates indicate that the following provisions are among the most significant tax cuts and tax increases for individuals in the new law:

Top individual tax Increases and tax cuts
(in \$ billions/over 10 years)

Tax increases 	Repeal personal exemptions	1,211.5
	Repeal/limit itemized deductions	668.4
	Reduce individual mandate penalty to zero	314.1
	Alternative inflation measure	133.5
	Require valid SSN for child tax credit	29.8
Tax cuts 	Restructure and lower rates and brackets	-1,214.2
	Increase standard deduction	-720.4
	Increase AMT exemption and phase-out	-637.1
	Increase child tax credit	-573.4
	Double Estate Tax Exemption	-83.0

**Estimates based on JCT conventional scores, not taking into account estimated growth in GDP. See JCX-67-17.*

Affordable Care Act modifications – “individual mandate”

The new law effectively repeals the individual mandate in the Patient Protection and Affordable Care Act by reducing the individual responsibility payment under section 5000A to zero for individuals who do not purchase health insurance that qualifies as minimum essential coverage, starting in 2019.

Taxation of investment income

The tax rates for capital gains and dividends are left unchanged. Also left unchanged is the 3.8% net investment income tax.

A Senate proposal to generally eliminate the ability of most taxpayers to use the specific identification method to identify the cost of any specified security sold, exchanged or otherwise disposed of was not included in the new law. As a result, pre-enactment law continues to apply to the specific identification method.

Exempt organizations

In addition to a number of generally applicable provisions that may affect exempt organizations (e.g., reduced corporate income tax rates, changes to the deductibility of various fringe benefits, and tax-exempt bond reform), the new law makes several changes that are specifically relevant to exempt organizations. In particular, the new law:

- Imposes an excise tax on compensation in excess of \$1 million and on “excess parachute payments” paid to certain employees of exempt organizations
- Imposes a 1.4% excise tax on the investment income earned by private colleges and universities with large endowments
- Requires unrelated business taxable income to be computed separately for each trade or business
- Increases unrelated business taxable income by the amount of certain fringe benefit expenses for which deductions are disallowed

The new law does not include a number of provisions relating to exempt organizations that were in the House bill (e.g., uniform rate for the excise tax on private foundation net investment income and a provision allowing section 501(c)(3) organizations to engage in de minimis political activity).



Effective dates and temporary provisions

In general

Many of the effective dates in the new law are based on tax years beginning after December 31, 2017. However, effective dates of some provisions, such as the following, are keyed off the date of enactment (December 22, 2017):

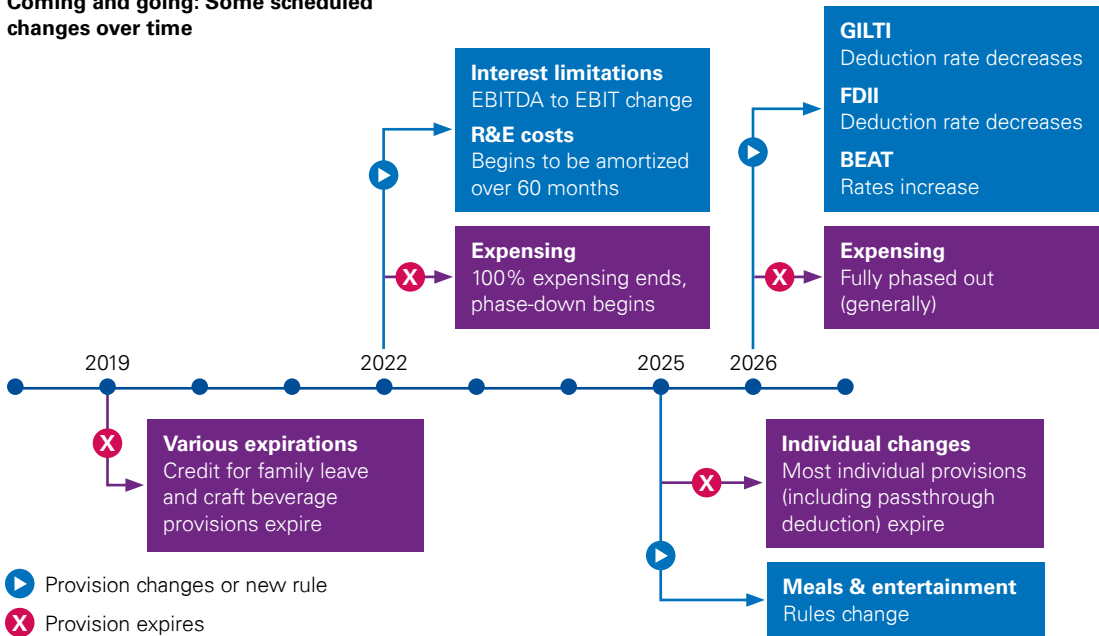
- Treatment of S corporation conversions into C corporations
- Certain retirement plan and casualty loss relief
- Rollovers from 529 accounts to ABLE accounts
- Increase in the excise tax on stock compensation in inversions
- The excise tax treatment of aircraft management services
- Deductions for certain settlements subject to nondisclosure agreements
- Expansion of nondeductibility of certain fines and penalties
- Repeal of deduction for local lobbying expenses
- Extension of time for contesting IRS levy

Other provisions have still different effective dates. For example, the temporary 100% expensing provision generally applies retroactively to property acquired and placed in service after September 27, 2017 and before 2023, while the change in treatment or R&E expenditures does not take place until 2022.

Moreover, as illustrated in the chart below, some of the new rules are scheduled to change over time, while a limited number of the business provisions, as well as most of the individual provisions (other than the new indexing method and the effective repeal of the individual mandate), are scheduled to expire.

Please read this report’s descriptions of specific provisions for a more complete discussion of effective dates and scheduled changes to, or expirations of, new rules.

Coming and going: Some scheduled changes over time



Effective dates for fiscal year filers – Code section 15

Code section 15 provides special rules for determining how certain “rate changes” apply to taxpayers whose tax years straddle relevant effective dates (e.g., fiscal year filers in the case of law changes that are effective as of the beginning or end of the calendar year).

The new law does not repeal or modify section 15, but it does include a provision explicitly indicating that section 15 does not apply to the temporary changes to the rates in new Code section 1(j). The provision permanently reducing the Code section 11 corporate rate, however, does not reference section 15. Thus, section 15 presumably would apply to the C corporation rate change without modification. Note also that new Code section 965(c)(2) (relating to treatment of deferred foreign income on transition to a participation exemption system) explicitly references U.S. shareholders to which section 15 applies. See section 14103 of the new law. The potential application of section 15 to other changes made by the new law (such as how it might apply to the repeal of the corporate AMT) is not completely clear and administrative guidance may be needed.

Section 15 generally applies if any rate of tax imposed by chapter 1 of the Code¹ changes and the tax year includes the effective date of the change (unless the effective date is the first day of the tax year). For this purpose, (1) if the rate changes for tax years “beginning after” or “ending after” a certain date, the following day is considered the effective date of the change; and (2) if the rate changes for tax years “beginning on or after” a certain date, that date is considered the effective date. In addition, if a tax imposed under Code chapter 1 is repealed, the repeal is considered a change of rate, with the rate after repeal being zero. Section 15, however, generally does not apply to inflation adjustments for individuals under section 1(f).² Further, as indicated above, under the new law, section 15 does not apply to the temporary rate changes under section 1.

If section 15 applies, the rate of tax for the year of the change generally is a blended rate. More specifically, section 15(a) states that:

- (1)** Tentative taxes shall be computed by applying the rate for the period before the effective date of the change, and the rate for the period on and after such date, to the taxable income for the entire tax year; and
- (2)** The tax for such tax year shall be the sum of that proportion of each tentative tax which the number of days in each period bears to the number of days in the entire tax year.

Further, if the rate change involves a change in the highest rate of tax imposed by section 1 or section 11(b), section 15(e) provides that any reference in Code chapter 1 to such highest rate (other than in a provision imposing a tax by reference to such rate) is treated as a reference to the weighted average of the highest rates before and after the change, determined by reference to the respective portions of the tax year before and on or after the change.

Possible need for subsequent clarifications

Given the sheer size of the new law and the rapid pace of developments from the start of the Ways and Means Committee’s markup to enactment, clarifications and corrections can be expected to be needed for some provisions.

It is possible that the JCT may release a “bluebook” general explanation of the new law. If so, the bluebook might attempt to clarify the intent regarding some provisions. However, for some issues, changes to the statute might still be needed to provide sufficient certainty.³

Nonetheless, enacting “corrective” legislation might not be easy, at least in the current Congress. It generally takes 60 votes for legislation to pass the Senate and it is not at all clear that changes to the new law would be able to garner that level of support. Moreover, using budget reconciliation procedures to move corrective legislation through the Senate with only 51 votes also could be challenging. For example:

- As a threshold matter, Congress would have to pass a budget resolution providing for revenue changes for the upcoming fiscal year to “unlock” the reconciliation process; however, it would be unlikely for such a budget resolution to be completed before spring of 2018 at the earliest.

¹ Chapter 1 consists of sections 1 through 1400.

² Under section 15(f), the section 15 rules also are inapplicable to certain rate changes that were enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001.

³ A number of judicial decisions have addressed the role of blue books. For example, see *U.S. v. Woods*, 134 S.Ct. 557 (2013), in which the Court explained that bluebooks: are “written after passage of the legislation and therefore d[o] not inform the decisions of the members of Congress who vot[e] in favor of the [law].” We have held that such “[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation.” While we have relied on similar documents in the past, our more recent precedents disapprove of that practice. Of course the Blue Book, like a law review article, may be relevant to the extent it is persuasive. [Citations omitted throughout quote.]

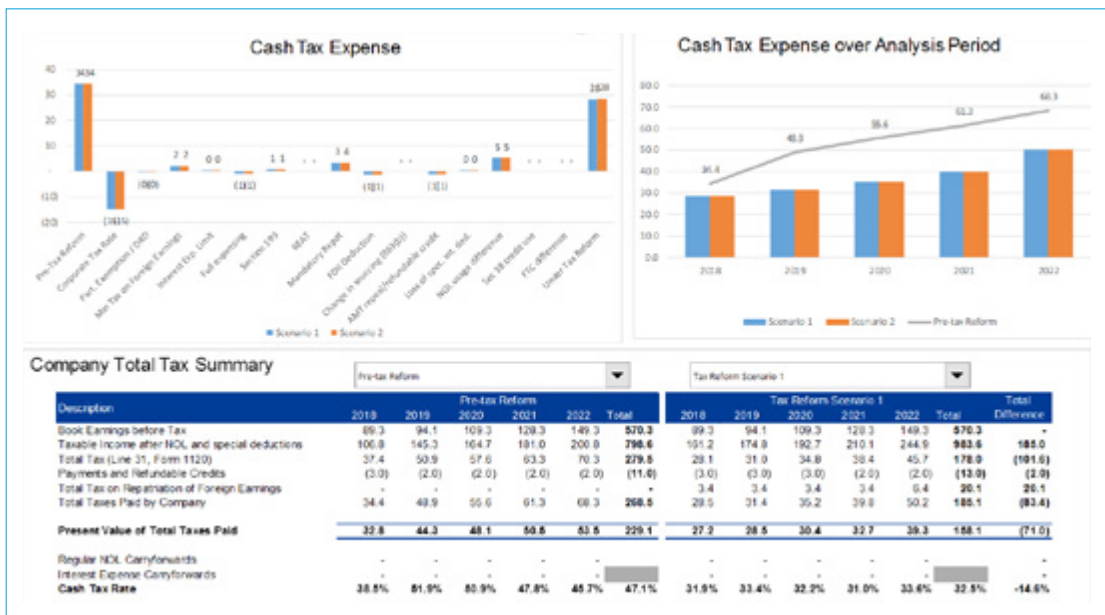
- In addition, “technical corrections” that make changes consistent with the initial intent of Congress typically are “scored” by the JCT as not having revenue impact; however, as indicated above, provisions that have no revenue effect may run afoul of the budget reconciliation requirements. Thus, if budget reconciliation were used, modifications might need to be drafted as substantive changes in law (with revenue impact), rather than as technical corrections.
- Further, even if changes could be made in a manner that complies with the procedural budget reconciliation requirements, those changes would need to pass the House and Senate to become law. At the time this report was published, the Senate was composed of 51 Republicans and 49 Democrats. Thus, absent any changes to the composition of the Senate, the Republicans could only lose one vote (assuming no Democratic support) to be successful in efforts to enact further tax law changes through budget reconciliation in 2018.



Practical considerations

The significant changes made by the tax law raise a host of planning issues and opportunities, as well as compliance considerations. Such practical issues and considerations are highlighted throughout this book. Some businesses also may want to model the potential impact of some changes, based on their particular facts and circumstances.

Illustration of some types of output from KPMG modeling tool



Documents

Read text of the tax bill, [H.R. 1](#) [PDF 491 KB] (185 pages)

The [conference agreement](#) [PDF 4.25 MB] (1097 pages), which includes a lengthy explanatory statement.

The JCT provided estimates of the budget effects of the conference agreement on H.R. 1. Read [JCX-67-17](#) – See Appendix A

Read [JCX-69-17](#) (Macroeconomic Analysis of the Conference Agreement for H.R. 1) – See Appendix B.

Read [JCX-68-17](#) (Distributional Effects of the Conference Agreement for H.R. 1) – See Appendix C.



Individuals

KPMG observation



Ordinary income tax rates – in general

The new law temporarily modifies the income rate structure under which individuals are taxed. Under pre-enactment law, there were seven rates: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The new law maintains the seven-rate structure, but taxes a taxpayer's income at modified rates: 10%, 12%, 22%, 24%, 32%, 35%, and 37%. The new rate structure is effective for tax years beginning in 2018, but ceases to apply after December 31, 2025.

The new law also includes special rules regarding the treatment of business income of individuals (e.g., individuals that conduct businesses through sole proprietorships, partnerships, and S corporations). See discussion of Passthrough Entities below.

The following table compares the 2018 tax brackets⁴ under pre-enactment law to those under the new law.

Married Taxpayers Filing Jointly

2018 – Prior Law		2018 – New Law	
Tax Rate	If taxable income is:	Tax Rate	If taxable income is:
10%	\$0 to \$19,050	10%	\$0 to \$19,050
15%	\$19,051 to \$77,400	12%	\$19,051 to \$77,400
25%	\$77,401 to \$156,150	22%	\$77,401 to \$165,000
28%	\$156,151 to \$237,950	24%	\$165,001 to \$315,000
33%	\$237,951 to \$424,950	32%	\$315,001 to \$400,000
35%	\$424,951 to \$480,050	35%	\$400,001 to \$600,000
39.6%	\$480,051 or more	37%	\$600,001 or more

Lower rates and generally higher tax brackets mean that a given amount of taxable income would generally attract a lower effective tax rate. However, since the calculation of taxable income would also change, not all taxpayers would experience a lower tax burden. Also note that, while the individual alternative minimum tax (discussed below) is modified by the new law, it was not repealed.

⁴ Prior to the enactment of PL. 115-97, the Internal Revenue Service announced the tax year 2018 annual inflation adjustments, including the 2018 tax rate schedules. See Rev. Proc. 2017-58 (October 19, 2017).

KPMG observation

Absent the possible mitigating impact of the increased standard deduction and the increased child and dependent tax credits, the new law eliminates much of the tax benefit that existed under prior law for a taxpayer filing as head of household versus filing as single.

Under pre-enactment law, the income thresholds for a head of household filer were more generous than for a single individual. The new law eliminates the discrepancy in income thresholds between a head of household filer and a single individual for all income subject to the 24% rate and above.

KPMG observation

The new law eliminates the so-called “marriage penalty” – the difference in tax liability of an unmarried couple filing as single taxpayers as opposed to filing jointly as a married couple – in all but the highest tax brackets, and thus also removes much of the disadvantage of the married filing separately filing status.

Married Taxpayers Filing Separately

2018 – Prior Law		2018 – New Law	
Tax Rate	If taxable income is:	Tax Rate	If taxable income is:
10%	\$0 to \$9,525	10%	\$0 to \$9,525
15%	\$9,526 to \$38,700	12%	\$9,526 to \$38,700
25%	\$38,701 to \$78,075	22%	\$38,701 to \$82,500
28%	\$78,076 to \$118,975	24%	\$82,501 to \$157,500
33%	\$118,976 to \$212,475	32%	\$157,501 to \$200,000
35%	\$212,476 to \$240,025	35%	\$200,001 to \$300,000
39.6%	\$240,026 or more	37%	\$300,001 or more

Head of Household

2018 – Prior Law		2018 – New Law	
Tax Rate	If taxable income is:	Tax Rate	If taxable income is:
10%	\$0 to \$13,600	10%	\$0 to \$13,600
15%	\$13,601 to \$51,850	12%	\$13,601 to \$51,800
25%	\$51,851 to \$133,850	22%	\$51,801 to \$82,500
28%	\$133,851 to \$216,700	24%	\$82,501 to \$157,500
33%	\$216,701 to \$424,950	32%	\$157,501 to \$200,000
35%	\$424,951 to \$453,350	35%	\$200,001 to \$500,000
39.6%	\$453,351 or more	37%	\$500,001 or more

Single

2018 – Prior Law		2018 – New Law	
Tax Rate	If taxable income is:	Tax Rate	If taxable income is:
10%	\$0 to \$9,525	10%	\$0 to \$9,525
15%	\$9,526 to \$38,700	12%	\$9,526 to \$38,700
25%	\$38,701 to \$93,700	22%	\$38,701 to \$82,500
28%	\$93,701 to \$195,450	24%	\$82,501 to \$157,500
33%	\$195,451 to \$424,950	32%	\$157,501 to \$200,000
35%	\$424,951 to \$426,700	35%	\$200,001 to \$500,000
39.6%	\$426,701 or more	37%	\$500,001 or more

The “kiddie tax”

Under pre-enactment law, the net unearned income of a child was taxed at the higher of the parents’ tax rates or the child’s tax rate. The new law simplifies how the tax on a child’s net unearned income (kiddie tax) is calculated, by effectively applying the ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child.

JCT estimate

The JCT has estimated that the new rate structure (subject to December 31, 2025 sunset) will decrease revenues by approximately \$1.2 trillion over 10 years.



New indexing method

The new law introduces a new method for indexing the tax rate thresholds, standard deduction amounts, and other amounts for inflation.

Under pre-enactment law, annual inflation adjustments were made by reference to the consumer price index (CPI). The new law, however, uses “chained CPI,” which takes into account consumers’ preference for cheaper substitute goods during periods of inflation.

Chained CPI will generally result in smaller annual increases to indexed amounts and was estimated by the JCT to increase revenues by approximately \$134 billion over 10 years.

The change to chained CPI for inflation indexing is effective for tax years beginning after 2017 and will remain in effect after 2025—it is not subject to the sunset provision that applies to other individual provisions.



Filing status, standard deductions, and personal exemptions

The new law retains the filing statuses available to taxpayers under pre-enactment law:

- Single
- Married filing jointly
- Married filing separately
- Head of household
- Qualifying widow(er) with dependent child

The new law imposes due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household and a \$500 penalty each time a paid preparer fails to meet these requirements.

The new law significantly increases the standard deduction for all taxpayers for tax years beginning after December 31, 2017. Under pre-enactment law, the standard deduction for 2018 would have been \$6,500 for a taxpayer filing as single or married filing separately, \$9,550 for a taxpayer filing as head of household, and

KPMG observation

The new law applies ordinary and capital gains rates applicable to trusts and estates to a child’s unearned income. For trusts and estates, the top rate of 37% applies at \$12,500 of taxable income.

KPMG observation

Under pre-enactment law, for the 2018 tax year a married couple with two qualifying dependent children would have had a standard deduction of \$13,000 and individual exemptions of \$16,600, for a combined deduction of \$29,600, \$5,600 greater than the deduction allowed under the new law. However, personal exemptions are subject to phase-outs under pre-enactment law and the new law includes an expanded child tax credit (discussed below) that may provide a greater tax benefit compared with the personal exemptions allowed under pre-enactment law. Additionally, the new rates and income thresholds in the new law may potentially offset any loss of benefit from the repeal of the personal exemption.

\$13,000 for taxpayers filing as married filing jointly. Under the new law, the standard deduction in 2018 is \$12,000 for a taxpayer filing as single or married filing separately, \$18,000 for a taxpayer filing as head of household, and \$24,000 for taxpayers filing as married filing jointly (and surviving spouses). These amounts will be adjusted for inflation for tax years beginning after December 31, 2018 and are scheduled to sunset December 31, 2025.

The new law retains the additional standard deduction for the elderly and the blind.

The temporary increase in the standard deduction, in conjunction with the repeal of many itemized deductions (discussed below), is intended to significantly reduce the number of taxpayers who itemize their deductions and thus to simplify the tax return preparation process. The increased standard deduction is also intended to compensate for the loss of the deduction for individual exemptions (which would have been \$4,150 for 2018 under prior law), which is suspended by the new law for tax years 2018 through 2025. The suspension applies to the exemptions for the taxpayer, the taxpayer's spouse, and any dependents.

The JCT has estimated that the modification to the standard deduction (subject to a December 31, 2025 sunset) will decrease revenues by approximately \$720 billion over 10 years and the repeal of deductions of personal exemptions (subject to a December 31, 2025 sunset) will increase revenues by approximately \$1.21 trillion over 10 years.



Reform of the child tax and qualifying dependents credits

Through tax year 2025, the new law increases the child tax credit to \$2,000 per qualifying child (up from \$1,000). The new law also temporarily provides a \$500 nonrefundable credit for qualifying dependents other than qualifying children.

Under the new law, \$1,400 of the child tax credit is refundable. The refundable portion will be indexed for inflation in future years using an indexing convention that rounds the \$1,400 amount to the next lowest multiple of \$100. The adjusted gross income (AGI) levels at which this credit is subject to phase-out increases from \$110,000 to \$400,000 for joint filers, and from \$75,000 to \$200,000 for single filers (these thresholds are not indexed for inflation). Additionally, the earned income threshold for the refundable child tax credit is lowered from \$3,000 under pre-enactment law to \$2,500. This threshold is not indexed for inflation.

The new law requires the taxpayer to provide a social security number (SSN) for each qualifying child for whom the credit is claimed on the tax return. This requirement does not apply to the \$500 nonrefundable credit for a non-child dependent. A qualifying child who is ineligible to receive the child tax credit due to not having a SSN is still eligible for the nonrefundable \$500 credit, including children with an Individual Taxpayer Identification Number rather than a SSN.

The JCT has estimated that the modifications to the child tax credit (subject to a December 31, 2025 sunset) will decrease revenues by approximately \$573 billion over 10 years and the SSN requirement (subject to a December 31, 2025 sunset) will increase revenues by approximately \$30 billion over 10 years.



Treatment of business income and losses of individuals

The new law provides a temporary new deduction for certain business income of individuals (as well as trusts and estates) earned for tax years beginning in 2018. Loss limitation rules are also expanded. These provisions are scheduled to sunset after 2025.

These provisions are relevant to many owners of businesses conducted as passthrough entities and sole proprietorships. See the Passthrough Entities section below for a more robust discussion of these provisions.



Tax rates on capital gains and dividends

The new law keeps in place the system whereby net capital gains and qualified dividends are generally subject to tax at a maximum rate of 20% or 15%, with higher rates for gains from collectibles and unrecaptured depreciation. The new law retains the same “breakpoints” for application of these rates as under pre-enactment law, except the breakpoints are adjusted for inflation after 2018. For 2018, the 15% breakpoint is \$77,200 for married taxpayers filing jointly, \$51,700 for head of household filers, and \$38,600 for all other filers. The 20% breakpoint is \$479,000 for married taxpayers filing jointly, \$239,500 for married taxpayers filing separately, \$452,400 for head of household filers, and \$425,800 for all other filers.

The new law also leaves in place the current 3.8% net investment income tax.



Suspension and reform of certain itemized deductions and income exclusions

Under pre-enactment law, individual taxpayers were able to claim itemized deductions to decrease taxable income. The new law includes a number of provisions suspending or modifying these deductions.

Combined, the JCT has estimated that the following provisions related to certain taxes, interest on mortgage debt, home equity debt, charitable contributions, non-disaster casualty losses, miscellaneous expenses, and the overall limitation on itemized deductions (all subject to a December 31, 2025 sunset) will increase revenue by approximately \$668 billion over 10 years.

KPMG observation

While a prepayment of 2018 state and local income tax may not be claimed as an itemized deduction for tax year 2017, the new law is silent on the deductibility of prepaid state and local real property taxes.

On December 27, 2017, the IRS advised that the allowance of a deduction for prepaid state or local real property taxes on a 2017 tax return depends on whether the taxpayer made the payment in 2017 and the real property taxes were assessed prior to 2018. The IRS indicated that the prepayment of anticipated real property taxes that were not assessed prior to 2018 are not deductible in 2017. State or local law determines whether and when a property tax is assessed.

Note that some taxpayers may have prepaid their state and local real property taxes prior to the IRS release about the deductibility of such payments. A number of state and local jurisdictions have announced that taxpayers may request a refund of the prepaid tax. Taxpayers who have prepaid state or local property taxes should consult the relevant tax authorities about the ability to claim a refund.

In addition, it remains to be seen whether the IRS will provide guidance or require certain ordering with respect to the deduction for state and local taxes as well as the application of the tax benefit rule for state income tax refunds received. To the extent taxpayers have both real property taxes and state income taxes, given a choice it may make sense to deduct the real property taxes first for purposes of the \$10,000 limitation to mitigate the application of the tax benefit rule related to any state income tax refunds.

KPMG observation

The provision to reduce the amount of debt that can be treated as acquisition indebtedness to \$750,000 was a compromise between the House bill, which would have reduced the debt limit to \$500,000, and the Senate bill which would have retained the current \$1 million limit.

Under the House bill, only interest paid on acquisition debt in respect of a taxpayer's principal residence would be included in the deduction. A taxpayer would not receive a deduction for interest paid on debt used to acquire a second home. The new law does not modify the treatment of interest attributable to mortgages secured by a second home (e.g., vacation homes). However, interest on the combined acquisition indebtedness of a taxpayer's principal residence and a second qualifying residence cannot exceed the \$750,000 cap, or \$1 million limit for grandfathered debt.

Deduction for taxes (including state and local taxes) not paid or accrued in a trade or business

Under the new law, in the case of an individual, itemized deductions for state and local income taxes, state and local property taxes, and sales taxes are limited to \$10,000 in the aggregate (not indexed for inflation). This cap does not apply to personal or real property taxes incurred in carrying on a trade or business or otherwise incurred for the production of income. In addition, foreign real property taxes, other than those incurred in a trade or business, are not deductible.

The effective date is for tax years beginning after December 31, 2017 and beginning before January 1, 2026.

The new law also does not permit an itemized deduction for 2017 on a prepayment of state or local income tax for a future tax year. Thus, a prepayment of 2018 state and local income tax paid in tax year 2017 cannot be claimed as an itemized deduction on an individual's 2017 income tax return.

Suspend and modify deduction for home mortgage interest and home equity debt

Under pre-enactment law, qualified residence interest was allowed as an itemized deduction, subject to limitations. Qualified residence interest included interest paid or accrued on debt incurred in acquiring, constructing, or substantially improving a taxpayer's residence ("acquisition indebtedness") and home equity indebtedness.

Interest on qualifying home equity indebtedness was deductible, regardless of how the proceeds of the debt were used, but such interest was not deductible in computing alternative minimum taxable income.

The new law suspends the deduction for interest on home equity indebtedness for tax years 2018 through 2025.

For the same tax years, the new law limits the deduction available for mortgage interest by reducing the amount of debt that can be treated as acquisition indebtedness from \$1 million to \$750,000.

Debt incurred before December 15, 2017, is not affected by the reduction and is therefore “grandfathered.” Any debt incurred before December 15, 2017, but refinanced later, continues to be covered by pre-enactment law to the extent the amount of the debt does not exceed the amount refinanced.

For tax years after December 31, 2025, the \$1 million limitation applies, regardless of when the indebtedness was incurred.

Increased percentage limitation for certain charitable contributions

The new law increases the AGI limitation for charitable contributions of cash made by individuals to public charities and certain private foundations to 60% (from a 50% limitation). This new rule applies to contributions made in tax years beginning after December 31, 2017 and before January 1, 2026.

Modify deduction for personal casualty and theft losses

Under pre-enactment law, a deduction could be claimed for any loss sustained during the tax year that was not compensated by insurance or otherwise, subject to certain limitations. The new law temporarily limits the deduction for personal casualty and theft losses to losses incurred in a federally declared disaster.

The effective date is for losses incurred in tax years beginning after December 31, 2017 and before January 1, 2026.

KPMG observation

Although the new law suspends the deduction for interest on home equity indebtedness, interest on proceeds from a home equity loan may be deductible if considered acquisition indebtedness. Proceeds from a home equity loan are considered acquisition indebtedness to the extent used for acquiring, constructing, or substantially improving a taxpayer’s residence provided all mortgage loans combined do not exceed the applicable limitation for acquisition indebtedness (\$750,000 for loans incurred on or after December 15, 2017, or \$1 million for grandfathered loans prior to such date).

KPMG observation

The new law follows the Senate bill. It retains the charitable contribution deduction, even increasing the amount individual taxpayers may claim as a deduction in a single tax year; however, other changes (e.g., lower tax rates and a higher standard deduction) may have an indirect impact on charitable giving. For a discussion of other changes affecting charitable giving (e.g., disallowed deduction for the right to purchase seating at a collegiate athletic event), see the Exempt Organizations discussion below.

This provision applies to trusts and estates as well as individual taxpayers. Thus, for the next eight years, trusts and estates are not permitted to take miscellaneous itemized deductions even to the extent that they exceed the 2% limitation. There is some uncertainty, however, as to whether the new law also prevents trusts and estates from deducting miscellaneous itemized expenses that would not have been incurred if the property were not held in a trust or estate (e.g., trustee fees and the cost of preparing a trust income tax return). Under pre-enactment law, trusts and estates were allowed an unlimited deduction (i.e., not subject to the 2% floor) for such expenses. It is not clear whether Congress intended to prevent trusts and estates from taking deductions for these sorts of unique costs as well.

Suspension of miscellaneous itemized deductions subject to the 2% floor

Under pre-enactment law, individuals were able to claim itemized deductions for certain miscellaneous expenses. Some expenses (for example, investment fees, repayments of income, and safe deposit box rental fees) were not deductible unless, in aggregate, the expenses exceeded 2% of the taxpayer's AGI. Unreimbursed business expenses incurred by an employee generally were deductible as an itemized deduction only to the extent the expenses exceeded 2% of AGI. Other miscellaneous expenses that were subject to the 2% floor would include the taxpayer's share of deductible investment expenses from passthrough entities, and certain repayments including items of income received under a claim of right (if \$3,000 or less).

The new law suspends miscellaneous itemized deductions for years 2018-2025. The effective date is for tax years beginning after December 31, 2017.

Suspension of overall limitation on itemized deductions ("Pease" limitation)

Under pre-enactment law, the total amount of allowable itemized deductions (with the exception of medical expenses, investment interest, and casualty, theft or gambling losses) was reduced by 3% of the amount by which the taxpayer's AGI exceeded a threshold amount (referred to as the "Pease" limitation).

The new law suspends the overall limitation on itemized deductions for years 2018-2025.

The effective date is for tax years beginning after December 31, 2017.

Suspension of exclusion for qualified bicycle commuting reimbursement

Pre-enactment law excluded up to \$20 a month in qualified bicycle commuting reimbursement from an employee's gross income. The new law suspends this exclusion for years 2018-2025 such that any reimbursement of this expense would be taxable.

The new law provision applies for tax years beginning after December 31, 2017.

The JCT has estimated this provision (subject to a December 31, 2025 sunset) will increase revenue by less than \$50 million over 10 years.

Suspension of exclusion for qualified moving expense reimbursements

Under pre-enactment law, qualified moving expense reimbursements were excludable from an employee's gross income and from the employee's wages for employment tax purposes. Such expenses included amounts received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses that would have been deductible as moving expenses if directly paid or incurred by the employee. Qualified moving expense

reimbursements did not include amounts actually deducted by the individual. For members of the U.S. Armed Forces (and family members), moving and storage reimbursements and allowances for these expenses were excluded from gross income.

The new law suspends the exclusion from gross income and wages for qualified moving expense reimbursements for years 2018–2025. The exclusion is preserved for U.S. Armed Forces members (and family members).

The effective date is for tax years beginning after December 31, 2017.

The JCT estimated that this provision (subject to a December 31, 2025 sunset) will increase revenues by approximately \$4.8 billion over 10 years. The estimate includes policy that retains the exclusion (under section 217(g)) related to members of the U.S. Armed Forces.

Suspension of deduction for moving expenses

Under pre-enactment law, individuals were permitted an above-the-line deduction for moving expenses paid or incurred in connection with starting work either as an employee or as a self-employed individual at a new principal place of work. These expenses were deductible only if specific distance and employment status requirements were met. In the case of certain members of the U.S. Armed Forces (and family members), the rules governing moving expenses also provided a special rule creating a targeted income exclusion for moving and storage expenses furnished in kind.

The new law suspends the deduction for moving expenses for years 2018–2025. However, the targeted rules providing income exclusions to members of the U.S. Armed Forces (or their spouse or dependents) are retained.

The effective date is for tax years beginning after December 31, 2017.

The JCT estimated that this provision (subject to a December 31, 2025 sunset) will increase revenue by approximately \$7.6 billion over 10 years. (Note that the retention of the target income exclusion rules for military families appears to be included in the revenue analysis for the general exclusion rule described above.)

Modification to the limitation on wagering losses

Under pre-enactment law, losses sustained on wagering transactions were allowed as a deduction only to the extent of gains from wagering.

The new law clarifies that “losses from wagering transactions” includes any deduction otherwise allowable that is incurred in carrying on any wagering transaction. Thus, the limitation on losses from wagering transactions applies to the actual costs of wagers incurred by an individual, and to other expenses incurred in connection with the conduct of the gambling activity. For instance, an individual’s otherwise deductible expenses in traveling to or from a casino are subject to the limitation.

KPMG observation

Suspension of the deduction for moving expenses can be expected to increase the cost of relocating employees. Businesses required to move employees to meet their business needs could face significantly higher costs after taking into account the gross-up for taxes.

The new law directs the Treasury to promulgate regulations to address any potential difference between the exclusion amount at the time of a gift and at the time of the death of the donor of such gift. Without such regulations, a gift that was covered by the enhanced exclusion (during the eight-year period) might result in estate tax liability at the donor's death if the exclusion has reverted to a lower amount. This is sometimes referred to as a "clawback" of the gift and was a concern raised by some commentators before 2012 when the \$5 million exclusion was scheduled to return to \$1 million. Although there are good arguments that clawback should not be an issue, it would be helpful to have regulations promulgated that make this clear.

The provision is effective for tax years beginning after December 31, 2017.

The JCT has estimated that this provision (subject to a December 31, 2025 sunset) will increase revenue by approximately \$100 million over 10 years.



Modification to individual AMT

The new law temporarily increases the AMT exemption amounts and the phase-out thresholds for individuals.

For married taxpayers filing a joint return (or for a surviving spouse): The AMT exemption amount for 2018 increases from \$86,200 under pre-enactment law to \$109,400. The phase-out threshold increases from \$164,100 to \$1,000,000.

For married taxpayers filing a separate return: The AMT exemption amount increases from \$43,100 (under pre-enactment law for 2018) to \$54,700. The phase-out threshold increases from \$82,050 to \$500,000.

For all other individual taxpayers: The exemption amount for 2018 under pre-enactment law was \$55,400. The new law raises this amount to \$70,300. The phase-out threshold increases from \$123,100 to \$500,000.

The increased exemption amounts and phase-out thresholds are scheduled to sunset after December 31, 2025.

The JCT has estimated that the temporary increase in the exemption amounts and phase-out thresholds will decrease revenues by approximately \$637 billion over 10 years.



Estate, gift, and generation-skipping transfer tax

The new law doubles the basic exclusion amount from \$5 million to \$10 million per individual (as indexed for inflation). This enhanced exclusion applies to estates of decedents dying, generation-skipping transfers made, and gifts made after 2017, but is scheduled to sunset after December 31, 2025. For 2018, it is anticipated that the exclusion will be close to \$11.2 million per person.

The JCT has estimated this provision (subject to the December 31, 2025 sunset) would decrease revenues by approximately \$83 billion over 10 years.

Other

Temporary reduction in medical expense deduction floor

Under the new law, individuals may deduct qualified medical expenses in excess of 7.5% of AGI for tax years 2017 and 2018 for regular tax and alternative minimum tax purposes. Under pre-enactment law, the deduction was limited to medical expenses in excess of 10% of AGI. After 2018, the 10% AGI threshold would be applicable.

The JCT has estimated the provision will decrease revenue by approximately \$5 billion over 10 years.

Allow increased contributions to ABLE accounts, and allow contributions to be eligible for saver's credit

The new law increases the contribution limit by a designated beneficiary to ABLE accounts. The overall limit on contributions remains the same (\$14,000 for 2017). After the limit is reached, the designated beneficiary may contribute an additional amount up to the lesser of the Federal poverty line for a one-person household as determined for the preceding calendar year, or the individual's compensation for the tax year. The designated beneficiary may claim the saver's credit for contributions to the ABLE account.

The provision applies to tax years beginning after the date of enactment, but is scheduled to sunset after December 31, 2025.

The JCT has estimated this provision will decrease revenues by less than \$50 million over 10 years.

Rollovers between qualified tuition programs and qualified ABLE programs

The new law provides that amounts from qualified tuition programs under section 529 may be rolled over to an ABLE account without penalty provided that the ABLE account is owned by the designated beneficiary of the 529 account or a member of the designated beneficiary's family. The rollover counts toward the overall limitation on amounts that can be contributed to an ABLE account in a tax year. Amounts in excess of the limit would be included in income as provided under section 72.

The provision is effective for tax years beginning after the date of enactment, but does not apply to distributions after December 31, 2025.

The JCT has estimated this provision will decrease revenues by less than \$50 million over 10 years.

KPMG observation

Under pre-enactment law, the deduction was limited to medical expenses in excess of 10% of AGI. For tax years before January 1, 2017, the threshold is 7.5% for seniors (age 65 or older).

KPMG observation

As approved on December 15, 2017, the conference agreement's definition of qualified higher education expenses included expenses related to home schooling. The home schooling language was deleted on December 20, 2017, after a point of order was successfully raised in the Senate. See Executive Summary for more information.

KPMG observation

The provisions in the new law are limited to 2016 disasters. Certain 2017 disasters – Hurricanes Harvey, Irma, and Maria – are addressed in the Disaster Tax Relief and Airport and Airway Extension Act of 2017, H.R. 3823, enacted on September 29, 2017.

Combat zone tax benefits to Armed Forces in Sinai Peninsula of Egypt

The new law grants combat zone tax benefits to Armed Forces members performing services in the Sinai Peninsula of Egypt, generally effective June 9, 2015. "Special pay" benefits include limited gross income and excise tax exclusions, surviving spouse benefits, and filing extensions. This provision is scheduled to sunset after 2025.

The JCT has estimated that the provision will decrease revenues by less than \$50 million over 10 years.

Exclude income from the discharge of student debt

The new law excludes any income resulting from the discharge of student debt due to death or disability. The exclusion applies to discharges of loans after December 31, 2017 and before January 1, 2026.

The JCT has estimated that the provision would decrease revenues by approximately \$100 million over 10 years.

Modification of education savings rules (529 plans)

Under pre-enactment law, earnings from 529 plans were not currently taxable for federal purposes and distributions were not taxable for federal purposes so long as the distributions were used for qualified higher education expenses such as tuition and room and board as well as fees, books, supplies, and equipment required for enrollment.

Under the new law, the definition of qualified higher education expenses is expanded to include public, private, and religious elementary and secondary schools.

The new law also limits the tax-free distribution amount to an aggregate of \$10,000 per student per year when used for expenses with respect to elementary and secondary schools. The \$10,000 per student per year limitation does not apply to distributions for post-secondary school expenses.

The provision is effective for distributions made after December 31, 2017 and is not subject to a sunset clause.

The JCT has estimated that the provision will decrease revenues by approximately \$500 million through 2025.

Relief for 2016 disaster areas

The new law provides tax relief for any area for which a major disaster has been declared by the president during 2016.

The new law provides an exception to the 10% early withdrawal tax related to a qualified 2016 disaster distribution from a qualified retirement plan, a section 403(b) plan, or an IRA. In addition, income attributable to such distribution is included in income ratably over three years. Further, the amount of the distribution may be recontributed to an eligible retirement plan within three years. The total amount of distributions from all eligible retirement plans that may be treated as qualified 2016 disaster distributions is \$100,000 per individual.

The new law also provides relief for personal casualty losses which arose in a 2016 disaster area where the loss was attributable to the events giving rise to the Presidential disaster declaration. The losses are deductible without regard to whether aggregate net losses exceed 10% of a taxpayer's AGI, as required under pre-enactment law. However, to be deductible the losses must exceed \$500 per casualty. The provision also allows the losses to be claimed in addition to the standard deduction. This relief applies to losses arising in tax years beginning after December 31, 2015 and before January 1, 2018.

The provision is effective on the date of enactment.

The JCT has estimated the provision will decrease revenues by approximately \$4.6 billion over 10 years.

Repeal of deduction for alimony payments and corresponding inclusion in gross income

Under pre-enactment law, alimony and separate maintenance payments were deductible by the payor spouse and includible in income by the payee spouse.

Under the new law, alimony and separate maintenance payments are not deductible by the payor spouse and are not includible in the income of the payee spouse. The effective date of this provision is delayed by one year. Thus, it is effective for any divorce or separation agreement executed after December 31, 2018, and for any agreement executed before but modified after that date if the modification expressly provides that this new provision applies to such modification. Unlike many of the provisions affecting individuals that are subject to sunset after 2025, the alimony changes are not scheduled to expire.

The JCT has estimated this provision will increase revenue by approximately \$6.9 billion over 10 years.

Eliminate deduction for member of Congress living expenses

Under pre-enactment law, Senators and House members were able to deduct up to \$3,000 per year in living expenses while away from their home states or Congressional districts. The new law repeals the ability to deduct these expenses for tax years beginning after the date of enactment. The JCT has estimated that this provision will increase federal revenues by less than \$50 million over a 10-year period.



Excluded House and Senate proposals

The following House and Senate proposals relevant to individuals were not included in the new law.

Modification of exclusion of gain on the sale of a principal residence: Individuals can exclude up to \$250,000 (\$500,000 if married filing jointly) of gain realized on the sale or exchange of a principal residence provided certain requirements regarding ownership and use are met. The House and Senate proposals

would have extended the length of time a taxpayer must own and use the residence to qualify for the exclusion. In addition, the House bill would have subjected the exclusion to phase-out for taxpayers whose income exceeded a specified threshold calculated as a three-year average.

Limitation on exclusion for employer-provided housing:

The House proposal would have limited the exclusion from gross income for employer-provided lodging to \$50,000, subject to phase-out based on the employee's level of compensation.

Sunset of exclusion for dependent care assistance programs:

An employee can exclude from gross income up to \$5,000 per year for employer-provided dependent care assistance. The House bill would have repealed the exclusion.

Repeal of exclusion for educational assistance programs: Up to \$5,250 annually of employer-provided educational assistance is excludable from an employee's gross income. The House bill would have repealed the exclusion.

Repeal of exclusion for adoption assistance programs:

An exclusion from an employee's gross income is allowed for qualified adoption expenses paid or reimbursed by an employer, if furnished pursuant to an adoption assistance program. For 2017, the maximum exclusion amount is \$13,570 and is phased-out ratably for taxpayers with modified AGI above certain thresholds. This provision is retained as provided under pre-enactment law.

Deduction for educator expenses: The House bill would have repealed the present-law provision allowing for above-the-line deductions for educator expenses. The Senate bill proposal would have temporarily increased the deduction limit for an educator's expenses from \$250 to \$500. Neither proposal was adopted in the new law, and the provision for a \$250 deduction is retained as provided under pre-enactment law.

Exclusion from gross income of certain amounts received by wrongly incarcerated individuals: A provision proposed by the Senate related to the exclusion from gross income of certain amounts received by wrongly incarcerated individuals was not included in the new law.





Affordable Care Act – Healthcare

The new law contains a significant amendment to the Patient Protection and Affordable Care Act (“Affordable Care Act” or ACA). Specifically, the excise tax imposed on individuals who do not obtain minimum essential coverage will be reduced to zero, starting in 2019.

However, no other ACA provisions are addressed in the new law, including provisions that have been the subject of other bills—such as the medical device excise tax and the annual health insurer fee.⁵



Reduce Affordable Care Act individual shared responsibility payment to zero

The individual shared responsibility provision requires individuals to be covered by a health plan that provides at least minimum essential coverage, or be subject to a tax for failure to maintain the coverage. The tax is imposed for any month that an individual does not have minimum essential coverage, unless the individual qualifies for an exemption.

Under the new bill, the amount of the individual shared responsibility payment is reduced to zero, starting in 2019.

This provision is not subject to the December 31, 2025, expiration date applicable to many other provisions affecting the taxation of individuals in this bill. The JCT has estimated that reducing the individual shared responsibility payment to zero will increase revenues by approximately \$314 billion over 10 years.

⁵ However, these two provisions (along with the excise tax on high cost employer-sponsored health coverage) were modified in the government funding bill enacted on January 22, 2018.



Business - In general



Reductions in corporate tax rate and dividends received deduction

The new law eliminates the progressive corporate tax rate structure, with a maximum corporate tax rate of 35%, and replaces it with a flat tax rate of 21% (and make various corresponding changes throughout the Code). Further, it eliminates the special corporate tax rate on personal service corporations (PSCs). The new rate is effective for tax years beginning after 2017.

In addition, the new law lowers the 80% dividends received deduction (for dividends from 20% owned corporations) to 65% and the 70% dividends received deduction (for dividends from less than 20% owned corporations) to 50%, effective for tax years beginning after 2017.

The new law also repeals the alternative corporate tax on net capital gain (Code section 1201).

The JCT has estimated that the rate reduction will decrease revenues by approximately \$1.35 trillion over 10 years.

KPMG observation

The corporate rate reduction is intended to make the U.S. corporate tax rate more competitive with the rates imposed by other countries. Consistent with the overall theme of the new law, this provision lowers tax rates in exchange for the elimination of certain tax benefits.

The corporate rate reduction effected by the new law may affect choice-of-entity decisions for some business entities. The flat 21% corporate tax rate differs from the effective rate for domestic business income of individuals earned through passthrough entities after giving effect to the 20% deduction discussed elsewhere in this document. Also as described elsewhere in this report, certain income from business activities of passthrough entities is still taxed at the individual rates, for which the new law provides a maximum tax rate of 37%.

The new law does not distinguish between investment income and business income earned by corporations for purposes of applying the 21% tax rate. In addition, even though Senate Finance Committee Chairman Hatch had been exploring integrating the corporate and individual income taxes, the new law does not contain a corporate integration proposal, meaning that corporate income subject

to a 21% rate could be subject to a further tax in the hands of shareholders when distributed to them as dividends. In making choice-of-entity determinations, taxpayers should consider the reduced corporate rate and the impact of other changes to the Code under the new law, as well as other Code provisions, such as the accumulated earnings and personal holding company taxes. Ultimately, choice-of-entity decisions will continue to depend on individual facts and circumstances.

The new law reduces the PSC tax rate to the general corporate tax rate. Generally, a professional service corporation is a C corporation (i) substantially all of the activities of which consist of the performance of services in fields such as accounting, health, law, etc., and (ii) of which employees performing services for the corporation in the identified fields own, directly or indirectly, substantially all of its stock. By reducing the general corporate rate and the PSC rate to 21%, and providing for a top 37% rate for individuals while limiting the passthrough deduction for personal service income, the new law may encourage the incorporation of personal service businesses.

As described in the introduction to this report, section 15 generally results in the application of a “blended” tax rate for tax years of fiscal year corporate taxpayers that include the effective date of the rate change (December 31, 2017).

The new law’s 21% corporate tax rate is slightly higher than the 20% rate proposed in the House and Senate bills. The effective date of the change is the same as in the House bill, but reflects a one-year acceleration from the effective date provided by the Senate bill.

The House and Senate bills had modified the dividends received deduction to provide parity between the marginal tax rate on dividends received by corporations (1) under pre-enactment law and (2) at a 20% rate. The new law does not further adjust the dividends received deduction to reflect a corporate rate of 21% (rather than 20%).

The corporate rate under the new law is substantially below the top individual tax rate (37%), which reestablishes the general relationship between these tax rates that was in place beginning with the enactment of the Revenue Act of 1913 until the enactment of the Tax Reform Act of 1986.

KPMG observation

Repealing the corporate AMT eliminates some of the complexity inherent in U.S. corporate taxation. For taxpayers with significant corporate AMT credit carryovers, the new law allows the full use of the credits to (i) reduce or eliminate regular tax liability, and (ii) obtain tax refunds to the extent the AMT credit carryovers exceed regular tax liability.

While the new law repeals the AMT, as discussed in the next part of this report, it also generally limits the NOL deduction for a given year to 80% of taxable income, adding a more restrictive version of the 90% limitation that existed only in the AMT regime. As shorthand, the 90% limitation in the AMT regime can be viewed as having imposed a 2% tax rate (20% AMT rate multiplied by the 10% of income that cannot be offset with an NOL deduction). This “shorthand” rate is 4.2% under the new law (21% corporate tax multiplied by the 20% of income that cannot be offset with NOLs).

In some prior years, sequestration under the Balanced Budget and Emergency Deficit Control Act of 1985 has reduced refunds of certain corporate AMT credits. The sequestration rate can vary, but may be 6.6% for fiscal year 2018. In the past, the IRS has stated that the sequestration rate would be applied unless and until a law is enacted that cancels or otherwise affects the sequester. Thus, AMT credit refunds claimed under the new law might be subject to reduction due to sequestration requirements.

The repeal of the corporate AMT in the new law is consistent with the House bill but represents a change from the Senate bill, which would have retained the corporate AMT. The Senate bill’s preservation of the corporate AMT, when combined with its 20% corporate tax rate, would have increased the number of corporations subject to the AMT and would have resulted in significant collateral consequences and additional complexity.

Natural resources

Taxpayers other than corporations continue to be subject to the AMT and may need to make adjustments for mine exploration and development costs (section 56(a)(2)(A)); mine depletion (sections 56(g)(F)(i) and 57(a)(1)); and the oil and gas and geothermal intangible drilling and development costs preference (section 57(a)(2)). Section 59(f) (which coordinates section 59(e) with a corporate section 291) is repealed by the new law. It appears that Congress did not expect corporations to use section 59(e) after 2017. A corporation with domestic NOLs and foreign source income covered by foreign tax credits may want to consider using section 59(e) to eliminate the domestic NOL.



Corporate AMT

The new law repeals the corporate AMT effective for tax years beginning after December 31, 2017. Any AMT credit carryovers to tax years after that date generally may be utilized to the extent of the taxpayer’s regular tax liability (as reduced by certain other credits). In addition, for tax years beginning in 2018, 2019, and 2020, to the extent that AMT credit carryovers exceed regular tax liability (as reduced by certain other credits), 50% of the excess AMT credit carryovers are refundable (a proration rule with respect to short tax years). Any remaining AMT credits will be fully refundable in 2021.

The JCT has estimated that the repeal of the corporate AMT will reduce revenues by approximately \$40.3 billion over a 10-year period.



Modified net operating loss deduction

The new law limits the net operating loss (NOL) deduction for a given year to 80% of taxable income, effective with respect to losses arising in tax years beginning after December 31, 2017. This limitation is similar to, although more restrictive than, the 90% limitation for NOLs that was in the corporate AMT regime (which, as indicated above, is repealed by the new law).

The new law also repeals the pre-enactment carryback provisions for NOLs; the statutory language indicates that this provision applies to NOLs arising in tax years ending after December 31, 2017, although it permits a new two-year carryback for certain farming losses and retains pre-enactment law for NOLs of property and casualty insurance companies. Pre-enactment law generally provides a 2-year carryback and 20-year carryforward for NOLs, as well as certain carryback rules for specific categories of losses (e.g., “specified liability losses” may be carried back 10 years). The repeal of the carryback provisions includes the repeal of the carryback limitations applicable to corporate equity reduction transactions (CERTs). The CERT rules are intended to prevent corporations from financing leveraged acquisitions or distributions with tax refunds generated by the carryback of interest deductions resulting from the added leverage. If applicable, the CERT rules can limit the amount of a NOL that can be carried to tax years preceding the year of the CERT.

The statutory language of the new law provides for the indefinite carryforward of NOLs arising in tax years ending after December 31, 2017, as opposed to a 20-year carryforward.

The JCT has estimated that the provision will increase revenue by approximately \$201.1 billion over 10 years (approximately \$45 billion more than the estimates for each of the House and Senate proposals).

KPMG observation

The new law does not appear to limit the three-year capital loss carryback allowed for corporations or impose a limitation on the utilization of capital loss carryovers.

The new law requires corporations to track NOLs arising in tax years beginning (1) on or before December 31, 2017, and (2) after December 31, 2017, separately, as only the latter category of NOLs would be subject to the 80% limitation.

The application of the 80% limitation to a tax year to which both (i) NOLs subject to the 80% limitation and (ii) NOLs not subject to such limitation can be carried over is not entirely free from doubt. For example, assume a calendar year taxpayer has \$90 of NOLs carried forward from its 2017 tax year (non-80% limited losses), \$10 of NOLs carried forward from its 2018 tax year (80% limited losses), and \$100 of income in its 2019 tax year. Arguably the taxpayer may utilize (i) all of the 2017 unlimited losses of \$90 and (ii) all of the 2018 limited losses of \$10, as the deduction of the 2018 NOL carryforward allowed under revised section 172(a) would be \$10, which is the lesser of (a) the NOL carryover subject to the 80% limitation (\$10) and (b) 80% of taxable income computed without regard to the NOL deduction (\$80). Alternatively, arguably the taxpayer cannot use any of \$10 NOL from 2018, because the aggregate NOL carryover deduction is limited to 80% of taxable income (again, computed without regard to the NOL deduction), or \$80. Under this interpretation, the available NOLs would be absorbed chronologically, i.e., \$90 of 2017 NOL is absorbed first (and is not subject to the 80% limitation), but no amount of the \$10 of 2018 NOL could be absorbed because the \$80 taxable income limitation had already been utilized by the 2017 NOL carryover. Although it is not free from doubt, there is a good argument that the former approach (allowing the deduction of the \$10 of 2018 NOLs in 2019) ought to apply.

The 80% limitation applies to losses arising in tax years beginning after December 31, 2017, whereas the statutory language regarding the indefinite carryover and the elimination (for most taxpayers) of the NOL carryback applies to losses arising in tax years ending

after December 31, 2017. Accordingly, under the statutory language, the NOLs of fiscal year taxpayers arising in tax years that begin before December 31, 2017 and end after December 31, 2017 would not be subject to the 80% limitation but (for most taxpayers) may not be carried back and may be carried forward indefinitely. However, the conference report's explanatory statement and the JCT revenue table for the conference agreement describe the effective date for the indefinite carryover and modification of carrybacks differently, indicating that the provision applies to losses arising in tax years beginning after December 31, 2017.

The changes to the NOL carryover provisions possibly may have a significant effect on the financial statement treatment of loss carryovers incurred in future tax years, given that unused loss carryovers no longer will expire. In addition, the potential 80% limitation on post-2017 NOLs and the elimination of post-2017 NOL carrybacks, combined with the reduction of the corporate tax rate, provides corporations with a significant incentive to accelerate deductions into 2017 and to defer income into 2018. Further, taxpayers may want to consider the interaction of the 80% limitation and the increased expensing allowances described elsewhere in this document. For

example, if a taxpayer's deduction for the purchase of property would give rise to an NOL, it may be advantageous to defer the purchase until the succeeding year (if full expensing is still available in that year), since the purchase could then offset 100% (not 80%) of taxable income in that succeeding year. In general, taxpayers may find it beneficial to stagger purchases as long as full expensing is available, or selectively elect out of full expensing for property in one or more depreciation recovery classes during this period, if doing so would avoid creating or increasing NOLs subject to the 80% limitation.

The NOL changes also remove the counter-cyclical effect of loss carrybacks in that corporations generating losses due to a business downturn or due to large environmental or product liability payments no longer will be able to carry back losses to obtain refunds of taxes paid in prior years.

The new law does not include a formula to increase NOL carryforwards by an interest factor over time, as was provided in the House bill.



Revisions to treatment of capital contributions

The new law modifies section 118, which provides an exclusion from gross income for contributions to the capital of a corporation. Specifically, the new law excludes from section 118 any contribution in aid of construction or any other contribution as a customer or potential customer, as well as any contribution by any government entity or civic group (other than a contribution made by a shareholder as such). This provision applies to contributions made after the date of enactment, unless the contribution is made by a government entity pursuant to a master development plan that is approved prior to the effective date by a government entity.

The JCT has estimated that the provision will increase revenue by approximately \$6.5 billion over 10 years.

KPMG observation

The new law's modifications to section 118 generally require corporations to include the specified types of contributions in gross income.

The new law significantly modifies the corresponding provision in the House bill (the Senate bill did not include a similar provision), which would have repealed Code sections 118 (that provides for nonrecognition by a corporation on the receipt of a contribution to capital) and 108(e)(6) (that harmonizes the discharge of indebtedness income rules with section 118) and enacted new Code section 76 (that affirmatively would have required corporations and partnerships to recognize income on the receipt of a contribution to capital). The report on the House bill indicated that these changes were intended to eliminate a federal tax subsidy for state and local incentives and concessions granted to corporations to incentivize them to locate operations within the grantor's jurisdiction. However, the changes in the House bill would have applied to a much broader range of situations than suggested by the policy description and would have created a number of apparently unintended and unexpected consequences, including a particularly destabilizing impact on workouts and efforts to rehabilitate troubled companies.

The summary explanation notes that the new law follows the policy of the House bill, but takes a different approach. The new law eliminates the House bill's specific section 76 recognition provision and limits section 118 nonrecognition in a manner consistent with the policy justification given for the House bill. This approach avoids many of the problematic and uncertain consequences raised by the House bill. See "Critique of House's Treatment of Capital Contributions," Tax Notes, Dec. 11, 2017, p. 1641.

The summary explanation also notes that the conferees, consistent with the Internal Revenue Service's current view, intend that section 118, as modified, continue to apply only to corporations.

The amendment making the inclusion of qualified real property elective may give taxpayers the ability to avoid or reduce their exposure to the dollar limit in certain cases.

Prior legislation, and IRS regulations issued in 2003 interpreting such legislation, provided specific rules for determining the acquisition date of self-constructed property for bonus depreciation purposes. The new law, however, is silent as to the determination of the acquisition date for self-constructed property. Thus, it is unclear whether prior law standards will be used for acquisition date determinations for self-constructed property under the new rules.



Cost recovery

Modification of rules for expensing depreciable business assets

Under the new law, the section 179 expensing election is modified to increase the maximum amount that may be deducted to \$1 million (up from \$500,000) (the dollar limit). The dollar limit is reduced dollar-for-dollar to the extent the total cost of section 179 property placed in service during the tax year exceeds \$2.5 million (up from \$2 million) (the phase-out amount). These limits will be adjusted annually for inflation. The changes are effective for property placed in service in tax years beginning after 2017.

Under pre-enactment law, the section 179 deduction for a sports utility vehicle is \$25,000. For tax years beginning after 2017, this limitation will be adjusted annually for inflation.

In addition, the new law expands the availability of the expensing election to depreciable tangible personal property used in connection with furnishing lodging (e.g., beds and other furniture for use in hotels and apartment buildings). The election also may include, at the taxpayer's election, roofs, HVAC property, fire protection and alarm systems, and security systems, so long as these improvements are made to nonresidential real property and placed in service after the date the realty was first placed in service. These expansions to the definition of property eligible for the section 179 expensing election are effective for property placed in service in tax years beginning after 2017.

The JCT has estimated that the provision will decrease revenues by approximately \$26 billion over 10 years.

Temporary 100% expensing for certain business assets

The new law extends and modifies the additional first-year depreciation deduction (bonus depreciation).

Under the new law, generally, the bonus depreciation percentage is increased from 50% to 100% for property acquired and placed in service after September 27, 2017, and before 2023. It also provides a phase down of the bonus depreciation percentage, allowing an 80% deduction for property placed in service in 2023, a 60% deduction for property placed in service in 2024, a 40% deduction for property placed in service in 2025, and a 20% deduction for property placed in service in 2026. These same percentages apply to specified plants planted or grafted after September 27, 2017, and before 2027. Longer production period property and certain aircraft get an additional year to be placed in service at each rate.

Property that is acquired prior to September 28, 2017, but placed in service after September 27, 2017, remains subject to the bonus depreciation percentages available under pre-enactment law (i.e., 50% for property placed in service in 2017, 40% for property placed in service in 2018, and 30% for property placed in service in 2019). Under the new law, the acquisition date for property acquired pursuant to a written binding contract is the date of such contract.

The new law changes the definition of qualified property (i.e., property eligible for bonus depreciation) by including used property acquired by purchase so long as the acquiring taxpayer had not previously used the acquired property and so long as the property is not acquired from a related party. In addition, the new law excludes any property used in providing certain utility services if the rates for furnishing those services are subject to ratemaking by a government entity or instrumentality or by a public utility commission, and any property used in a trade or business that has “floor plan financing indebtedness.”

In addition, the new law creates a new category of qualified property that includes qualified film, television, and live theatrical productions, as defined under section 181(d) and (e), effective for productions placed in service after September 27, 2017, and before 2027. Under the agreement, a production is treated as placed in service on the date of its first commercial exhibition, broadcast, or live staged performance to an audience.

In the case of a taxpayer’s first tax year ending after September 27, 2017, the new law permits the taxpayer to elect to apply a 50% allowance in lieu of 100%.

The JCT has estimated that the provision will decrease revenues by approximately \$86.3 billion over 10 years.

KPMG observation

As in the House and Senate bills, the new law excludes from bonus-eligible qualified property any property used in trades or businesses that is not subject to the limitation of net business interest expense under section 163(j). The new law also expands the exclusion from the interest expense limitation to include property used in a farming business, but subjects such property with a recovery period of 10 years or more to ADS (and by definition such property would not be qualified property eligible for bonus depreciation). While the new law removes qualified improvement property from the definition of qualified property for bonus depreciation purposes, such property appears to remain bonus eligible since it would now have a specified recovery period of 15 years and thus meet the general “20 years or less recovery period” requirement for bonus qualification.

The change in the definition of qualified property could have an important effect on M&A transactions. It increases the incentive for buyers to structure taxable acquisitions as actual or deemed (e.g., pursuant to section 338) asset purchases, rather than stock acquisitions, by enabling the purchasing entity in an asset acquisition to immediately deduct a significant component of the purchase price, and potentially to generate net operating losses in the year of acquisition that could be carried forward (subject, in general, to an 80% of taxable income limitation as described elsewhere in this document) to shield future income.

KPMG observation

The new law incorporates the most favorable provisions of both the House and Senate bills by expanding the availability of bonus depreciation to purchased non-original use property, and by instituting a four-year phase-down period from 2023 through 2026.

KPMG observation

This provision substantially changes the treatment of R&E and software development costs. Under section 174, a taxpayer may currently expense R&E costs under section 174(a) or elect to treat R&E costs as deferred expenses under section 174(b), and such deferred expenses are allowed as a deduction ratably over such period of not less than 60 months as may be selected by the taxpayer (beginning with the month in which the taxpayer first realizes benefits from such expenditures). Further, under pre-enactment law, an election to recover section 174 amounts over 10 years is available under section 59(e), which itself would have been repealed under the overall AMT repeal that had been proposed earlier in the legislative process; however, only the corporate AMT has been repealed and modifications have been made to the individual AMT with section 59(e) itself remaining as is. Reg. section 1.174-2 provides a general definition of R&E expenditures, and it does not appear that this definition would change under the new law.

The IRS has had a longstanding rule of administrative convenience that permits taxpayers to treat the costs of developing software as deductible section 174 expenses, whether or not the particular software is patented or copyrighted or otherwise meets the requirements of section 174. See Rev. Proc. 2000-50 and its predecessor Rev. Proc. 69-21. The new law terminates this rule of convenience and requires capitalization of software development expenses otherwise eligible for expensing under Rev. Proc. 2000-50.

Requirement to capitalize section 174 research and experimental expenditures

The new law provides that specified research or experimental (R&E) expenditures under section 174 paid or incurred in tax years beginning after December 31, 2021 should be capitalized and amortized ratably over a five-year period, beginning with the midpoint of the tax year in which the specified R&E expenditures were paid or incurred. Specified R&E expenditures which are attributable to research that is conducted outside of the United States (for this purpose, the term "United States" includes the United States, the Commonwealth of Puerto Rico, and any possession of the United States) would be capitalized and amortized ratably over a period of 15 years, beginning with the midpoint of the tax year in which such expenditures are paid or incurred. Specified R&E expenditures subject to capitalization include expenditures for software development.

In the case of retired, abandoned, or disposed property with respect to which specified R&E expenditures are paid or incurred, any remaining basis may not be recovered in the year of retirement, abandonment, or disposal, but instead must continue to be amortized over the remaining amortization period.

The application of this rule is treated as a change in the taxpayer's method of accounting for purposes of section 481, initiated by the taxpayer, and made with the consent of the Secretary. This rule is applied on a cutoff basis to R&E expenditures paid or incurred in tax years beginning after December 31, 2021 (hence there is no adjustment under section 481(a) for R&E expenditures paid or incurred in tax years beginning before January 1, 2022).

The JCT has estimated that this provision will raise approximately \$119.7 billion in the 10-year budget window (taking into account the delayed effective date).

Modifications to depreciation limitations on luxury automobiles and personal use property

The new law increases the depreciation limitations for passenger automobiles placed in service after 2017. If bonus depreciation is not claimed, allowable depreciation is limited to \$10,000 in year one; \$16,000 in year two; \$9,600 in year three; and \$5,760 in all subsequent years.

These limitations will be indexed for inflation for automobiles placed in service after 2018.

Computers and peripheral equipment placed in service after 2017 would no longer be considered “listed property,” and thus would not be required to be depreciated using the straight-line method if their business use falls below 50%.

The JCT included the estimated revenue impact of this provision with that for the provision to increase and expand bonus depreciation.

Modifications of treatment of certain farm property

The new law shortens the depreciation recovery period of certain machinery and equipment used in a farming business from seven to five years. To be eligible for the shortened recovery period, the equipment must be placed in service after 2017 and the taxpayer must be the original user of the equipment.

Under pre-enactment law, property with depreciation recovery periods of 10 years or less that is used in a farming business is required to be depreciated using the 150% declining balance method instead of the 200% declining balance method for which it would otherwise be eligible. The new law repeals this requirement for property placed in service after 2017.

The new law also requires any farming trade or business that elects out of the interest deduction limitation to depreciate property with a recovery period of 10 years or more using ADS, in tax years beginning after 2017.

The JCT has estimated the provision will decrease revenue by approximately \$1.1 billion over 10 years.

Applicable recovery period for real property

The new law eliminates the special 15-year recovery period for qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property; instead, it seems intended to provide a single 15-year recovery period (20 years for ADS) for qualified improvement property, defined as certain interior improvements to nonresidential real property that are placed in service after the initial placed-in-service date of the realty. However, the legislative text itself seems to include a “technical glitch,” which leaves the applicable recovery periods (both MACRS and ADS) for qualified improvement property uncertain.

KPMG observation

Qualified restaurant property, which under pre-enactment law had a 15-year recovery period, includes section 1250 building and building improvement property. It may include newly constructed property that is otherwise qualified. Since the new law limits the 15-year recovery period to qualified restaurant property that meets the definition of qualified improvement property, a large portion of restaurant building and building improvement property would be required to be depreciated as nonresidential real property over a 39-year recovery period. Additionally, as indicated above, a technical glitch in the legislative text appears to result in uncertainty as to whether qualified improvements of any nature (not just restaurant property) would be eligible for the benefits of a shorter life and bonus depreciation.

As described above, the new law's cost recovery requirements relating to real property trades or businesses that elect out of the interest deduction limitations apply for tax years beginning after 2017. As such, the election out would affect property already placed in service for the year the election is made. As indicated in the explanation to the Senate bill that was posted on the Budget Committee Web site, the election out would require the taxpayer to treat a change in the recovery period and method as a change in use.

In addition, the ADS recovery period for residential rental property is shortened from 40 years to 30 years.

These provisions are effective for property placed in service after 2017.

The new law also requires any real property trade or business that elects out of the interest deduction limitation to depreciate building property under ADS. As a result, a real property trade or business's nonresidential real property and residential rental property would be depreciated using the straight-line method over 40 years and 30 years, respectively, and its qualified improvement property would be depreciated using the straight-line method over 20 years. This provision is effective for tax years beginning after 2017.

The JCT has estimated these provisions will decrease revenue by approximately \$4.9 billion over 10 years.

Expensing certain citrus replanting costs

The new law provides a special rule for replanting costs paid or incurred after the date of enactment, but not more than 10 years after such date, for citrus plants lost or damaged due to casualty. Under the rule, such costs may be deducted by a person other than the taxpayer if either (1) the taxpayer has an equity interest of at least 50% in the replanted citrus plants and the other person owns the remaining equity interest, or (2) such other person acquires all the taxpayer's equity interest in the land on which the citrus plants were located when damaged and replants on such land.

The JCT has estimated that this provision will lose less than \$50 million over a 10-year period.



Business-related deductions, exclusions, etc.

Limitation on the deduction of net business interest expense

The new law amends section 163(j) to disallow a deduction for net business interest expense of any taxpayer in excess of 30% of a business's adjusted taxable income plus floor plan financing interest. The conference report's explanatory statement indicates that the section 163(j) limitation should be applied after other interest disallowance, deferral, capitalization or other limitation provisions. Thus, the provision would apply to interest the deduction for which has been deferred to a later tax year under some other provision.

The new limitation does not apply to certain small businesses, that is, any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) that meets the gross receipts test of section 448(c) (which is modified to \$25 million under section 13102 of the new law) for any tax year. This exception to the limitation applies to taxpayers with average annual gross receipts for the three-taxable-year period ending with the prior tax year that do not exceed \$25 million.

The new limitation also does not apply to the trade or business of performing services as an employee or to certain regulated public utilities and electric cooperatives. In addition, certain taxpayers may elect for the interest expense limitation not to apply, such as certain real estate businesses and certain farming businesses; businesses making this election are required to use the alternative depreciation system (ADS) to depreciate certain property. For an electing real estate business, ADS would be used to depreciate nonresidential real property, residential rental property, and qualified improvement property. For an electing farming business, ADS would be used to depreciate any property with a recovery period of 10 years or more.

Adjusted taxable income generally is a business's taxable income computed without regard to (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) business interest or business interest income; (3) the amount of any net operating loss deduction; (4) the 20% deduction for certain passthrough income, and (5) in the case of tax years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion. The new law permits the Secretary to provide other adjustments to the computation of adjusted taxable income. A business's adjusted taxable income may not be less than zero for purposes of the limitation.

Business interest is defined as any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for tax purposes is treated as "interest" for purposes of this provision. The term "business interest" does not include investment interest within the meaning of section 163(d). The conference report's explanatory statement indicates that, because section 163(d) does not apply to corporations, a corporation has neither investment interest nor investment income and interest income and interest expense would be properly allocable to a trade or business unless such trade or business has been explicitly excluded from the provision.

"Floor plan financing interest" is interest paid or accrued for "floor plan financing indebtedness," which means indebtedness used to finance the acquisition of motor vehicles held for sale or lease. The term "motor vehicle" means any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road, boat, or farm machinery or equipment.

Subject to the exclusions for those businesses that may elect out, the provision applies to all businesses, regardless of form, and any disallowance or excess limitation would generally be determined at the filer level (e.g., at the partnership level instead of the partner level). Although it is not entirely clear, section 163(j) is drafted broadly enough to limit the interest expense of a controlled foreign corporation for purposes of determining subpart F income, tested income, and the GILTI inclusion under section 951A. For a group of affiliated corporations that join in filing a consolidated return, the conference report's explanatory statement says that the provision applies at the consolidated tax return filing level, although the provision itself does not address this point. Subject to the special rules for partnerships, any business interest disallowed would be carried forward indefinitely. Carryover amounts are taken into account in the case of certain corporate acquisitions described in section 381 and are subject to limitation under section 382. Neither the statutory language nor the legislative history refers to the treatment of interest disallowed under section 163(j) in determining the earnings and profits of a corporation; proposed regulations under prior section 163(j) (which had a very similar disallowance and carry-forward mechanism) provided that the earnings and profits reduction would occur in the year the interest was paid or accrued rather than the year in which the deduction was ultimately allowed.

Special carryforward rules, described below, apply to partners in the case of business interest not allowed as a deduction to a partnership. These special carryforward rules do not apply in the case of an S corporation. The general carryforward rule applies to an S corporation.

The new law prevents a partner (or shareholder of an S corporation) from double counting a partnership's (or S corporation's) adjusted taxable income when determining the partner's (or shareholder's) business interest limitation. More specifically, a partner's (or shareholder's) adjusted taxable income is determined without regard to the partner's (or shareholder's) distributive share of the partnership's (or S corporation's) items of income, gain, deduction, or loss.

The conference report's explanatory statement illustrates the double counting rule with the following example. ABC is a partnership owned 50-50 by XYZ Corporation and an individual. ABC

generates \$200 of noninterest income. Its only expense is \$60 of business interest. Under the provision, the deduction for business interest is limited to 30% of adjusted taxable income, that is, $30\% \times \$200 = \60 . ABC deducts \$60 of business interest and reports ordinary business income of \$140. XYZ's distributive share of the ordinary business income of ABC is \$70. XYZ has net taxable income of zero from its other operations, none of which is attributable to interest income and without regard to its business interest expense. XYZ has business interest expense of \$25. In the absence of a double counting rule, the \$70 of taxable income from XYZ's distributive share of ABC's income would permit XYZ to deduct up to an additional \$21 of interest ($30\% \times \$70 = \21), and XYZ's \$100 share of ABC's adjusted taxable income would generate \$51 of interest deductions, well in excess of the intended 30% limitation. If XYZ were a passthrough entity rather than a corporation, additional deductions might be available to its partners as well, and so on.

The double-counting rule prevents this result by providing that XYZ has adjusted taxable income computed without regard to the \$70 distributive share of the nonseparately stated income of ABC. As a result, it has adjusted taxable income of \$0. XYZ's deduction for business interest is limited to $30\% \times \$0 = \0 , resulting in a deduction disallowance of \$25.

The new law allows a partner or shareholder to use its distributive share of any excess (i.e., unused) taxable income limitation of the partnership or S corporation in computing the partner's or shareholder's business interest limitation. The excess taxable income with respect to any partnership is the amount that bears the same ratio to the partnership's adjusted taxable income as the excess (if any) of 30% of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership exceeds the business interest income of the partnership bears to 30% of the adjusted taxable income of the partnership. Any such excess adjusted taxable income is allocated in the same manner as nonseparately stated income and loss.

The explanatory statement provides the following example. Assume the partnership described above had only \$40 of business interest. ABC has a limit on its interest deduction of \$60. The excess of this limit over the business interest of the partnership is $\$60 - \$40 = \$20$. The excess taxable income for ABC is $\$20 / \$60 * \$200 = \66.67 . XYZ's distributive share of the excess taxable income from ABC partnership is \$33.33. XYZ's deduction for business interest is limited to 30% of the sum of its adjusted taxable income plus its distributive share of the excess taxable income from ABC partnership ($30\% * (\$0 + \$33.33) = \$10$). As a result of the rule, XYZ may deduct \$10 of business interest and has an interest deduction disallowance of \$15.

As noted earlier, special carryforward rules apply to partners and partnership. Excess business interest of a partnership is not treated as paid or accrued by the partnership in the succeeding tax year. Instead excess business interest is allocated to each partner in the same manner as the nonseparately stated taxable income or loss of the partnership. Excess business interest allocated to a partner is treated as business interest paid or accrued by the partner in the next succeeding tax year in which the partner is allocated excess taxable income from the partnership but only to the extent of such excess taxable income. Any remaining excess business interest can be carried forward by the partner and deducted subject to the excess taxable income limitation. A partner's adjusted basis in its partnership interest is reduced (but not below zero) by the amount of excess business interest allocated to the partner. If a partner disposes of its partnership interest, including in a nonrecognition transaction, the partner's basis in the interest is increased, immediately prior to the disposition, by the excess of (i) the amount basis was reduced as described above over (ii) the amount of excess business interest allocated to the partner and treated as paid or accrued in a succeeding tax year.

The provision is effective for tax years beginning after 2017.

The JCT has estimated the provision will increase revenues by approximately \$253.4 billion over 10 years.

KPMG observation

Under the new law, any net interest disallowance applies at the filer level rather than the taxpayer level. Thus, the determination is made at the partnership rather than the partner level. This affects not only the determination of any interest disallowance, but also any excess amount (i.e., interest expense capacity) passed through from a partnership or S corporation to its partners or shareholders, respectively. Consideration would need to be given in tiered structures to whether business interest expense is subject to any disallowance given that the limitations are applied at each level. There may also be uncertainties created when applying the rules at the partnership level when references are made to the rules of section 469 which apply at the partner level. Guidance also is needed as to how to apply the new limitation at the partnership level for items such as allocations under section 704(c) or basis adjustments under section 743.

As was explained above, special rules allow a partnership's or S corporation's unused interest limitation for the year to be used by its partners and shareholders, respectively, and to ensure that net income from the passthrough entity is not double counted at the partner or shareholder level. With respect to the double-counting rule, the new law excludes a partner's or shareholder's distributive share of all items of income, gain, deduction, or loss. Clarification may be needed to address how business interest income of a partnership or S corporation is taken into account at the partner or shareholder level for purposes of applying section 163(j).

The new provision applies only to business interest expense of the taxpayer. Nonbusiness interest, such as investment interest expense, continues to be subject to the limitation on investment interest. Payments that are not interest, such as capitalized debt costs that are amortized like OID under Reg. section 1.446-5, are not covered.

The provision includes only taxable interest income in the computation of net business interest expense. Thus, investments in tax-free municipal bonds do not increase a taxpayer's interest expense capacity.

While the new law does not explicitly indicate how the new rule interacts with other interest disallowance and deferral provisions, the explanatory statement indicates that the provision is intended to apply after other interest disallowance and deferral provisions.

As explained above, the new provision provides relief for electing real property trades or businesses that agree to use ADS for certain property. Guidance will be needed as to what constitutes a real property trade or business for this purpose. Taxpayers then would need to determine if and when to make the election.

In addition, there appear to be no special rules for financial services entities. As a result, the determination of net business interest expense is unclear for a company like an insurer that generates significant interest income related to investments as an integral part of its active insurance business.

It should be noted that interest expense can occur as a result of repurchasing one's debt instrument at a premium. Under Reg. section 1.163-7(c), if a borrower repurchases its debt instrument for an amount in excess of its adjusted issue price, the repurchase premium is deductible as interest for the tax year in which the repurchase occurs, unless the deduction for the repurchase premium is disallowed under section 249 or the repurchase premium was the result of certain debt-for-debt exchanges.

Finally, the new provision does not address what happens to a corporation's existing disallowed interest expense for which a deduction was not claimed because of section 163(j). Thus, it is unclear if Congress intends that a corporation may treat that disallowed interest expense as business interest paid or accrued in a year after the effective date of the provision.

KPMG observation

Congress's intent in enacting section 199 was to provide a targeted corporate rate reduction that would allow U.S. companies to compete against international tax systems, while also drawing international companies to the United States and its tax structure. While the new law eliminates the rate reduction created by section 199, a separate provision of the legislation effects a much larger overall corporate rate reduction, as discussed above.

The repeal of section 199 applies to tax years beginning after December 31, 2017, so fiscal year taxpayers would still be able to claim the section 199 deduction for fiscal years ending after December 31, 2017, but beginning before the repeal date. In addition, as discussed in the Executive Summary, special rules apply to corporate taxpayers whose tax years straddle the effective date. The rules under section 15 generally result in application of a blended corporate rate to taxable income for the year that straddles the effective date. As a result, fiscal year corporate taxpayers would be eligible for a section 199 deduction reflecting qualifying production activities income for the entire tax year that begins before January 1, 2018, and ends after December 31, 2017, and would claim the deduction against taxable income that is subject to partial impact of the 21% corporate tax rate.

KPMG observation

The ordinary income treatment represents a paradigm shift from the definition of "capital asset" and various rules for timing and character of income for certain self-created works. Taxpayers who have applied the special character rules to these types of self-created property would find their gains and losses characterized as ordinary under the statutory language. Under the new provision, gain or loss on the disposition of other self-created intangibles, such as personal goodwill, client lists, customer contracts, etc., are still eligible for capital gain treatment. As a result of this law change, valuations may become more important in the context of a sale of a business containing multiple identifiable intangibles.

The new law followed the House bill without modifications. The legislative history notes that the provision is consistent with the principle in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46 (1955), in that the intent of Congress is that profits and losses arising from everyday business operations be characterized as ordinary income and loss and, as such, the general definition of capital asset should be narrowly applied. However, the new law did not follow the House bill with respect to the proposed repeal of section 1235, which provides capital gain treatment on the transfer of a patent prior to actual commercial use of the patent.

Repeal deduction for income attributable to domestic production activities

Under the new law, the deduction for domestic production activities provided under section 199 is repealed for tax years beginning after December 31, 2017.

JCT has estimated that repealing section 199 will increase revenues by approximately \$98 billion from 2018 to 2027.

Modify tax treatment of certain self-created property

Under the new law, gain or loss arising from the sale, exchange, or other disposition of a self-created patent, invention, model or design, secret formula or process, are no longer treated as the sale of a capital asset under section 1221(a)(3).

This provision applies to dispositions after December 31, 2017.

JCT has estimated that this modification will increase revenues by \$500 million over 10 years.

Repeal of rollover of publicly traded securities gain into specialized small business investment companies

In certain circumstances, section 1044 allowed a taxpayer to defer capital gain income on the sale of publicly traded securities by “rolling over” the proceeds of such sale to purchase interests in a “specialized small business investment corporation” (SSBIC). An SSBIC is a type of investment fund licensed by the U.S. Small Business Administration. While the program was repealed in 1996, certain grandfathered SSBICs still exist.

The new law repeals this provision, effective for sales after 2017.

The JCT has estimated that this provision will increase revenues by approximately \$1.7 billion over 10 years.

Limits on like-kind exchange rules

Section 13303 of the new law limits the like-kind exchange rules under Code section 1031 to exchanges of real property. Deferral under section 1031, however, is not allowed for an exchange of real property held primarily for sale. In addition, as under pre-enactment law, real property located in the United States is not considered like-kind to real property located outside the United States.

The new section 1031 rules apply to exchanges completed after December 31, 2017. A transition rule is included under which the new section 1031 rules do not apply to any exchange in which the taxpayer disposed of relinquished property, or received replacement property, on or before December 31, 2017.

The JCT has estimated that the provision will raise revenue by approximately \$31 billion over a 10-year period.

KPMG observation

The sale of shares in an SSBIC may qualify for the gross income exclusion for certain sales of small business stock contained in section 1202; the new law makes no change to section 1202. However, generally any gain deferred under section 1044 that is realized on the sale of the SSBIC shares is not eligible for the gross income exclusion under section 1202.

KPMG observation

The new law’s limitation on the like-kind exchange rules eliminates deferral under section 1031 for exchanges of tangible personal property, including livestock, and intangible property. For tangible personal property, the new law’s allowance for full expensing may offset the negative impact of eliminating the gain deferral under section 1031. However, for personal property not subject to full expensing and intangible property, the limitation to section 1031 would have an adverse impact.

Economic interests in unsevered oil and gas, minerals and timber are real property that remain eligible for like-kind exchange treatment (e.g., poolings and unitizations). Although an interest in a partnership is not eligible for like-kind exchange treatment, the new law provides that, if a partnership has made a valid election under section 761(a) to be excluded from subchapter K, a partner that transfers a partnership interest is treated as transferring an interest in the assets of the partnership. Thus, if the partnership’s assets are eligible real property, like-kind exchange treatment may still be available. The new law also eliminates the special rule under pre-enactment law that characterizes certain stock in a mutual ditch, reservoir, or irrigation company as real property eligible for like-kind exchange treatment under section 1031.

Meals, including de minimis food and beverages that used to be 100% deductible, are generally 50% deductible under the new law. There remains uncertainty regarding whether the meals provided during a recreational event fall under the meal or recreational deduction limit, such as a meal in connection with a business meeting at a ballgame.

The new law essentially provides the employer with a choice to include certain de minimis or convenience of employer meals in employee taxable income and take a 100% tax deduction or exclude the amounts and take a lesser deduction.

Commuting expenses are not deductible under the new law except to ensure the safety of the employee. The factual situations that would satisfy the safety exception remain uncertain. This new law language could be read to suggest that even taxable commuting may not be deductible, but it seems unlikely that this was intended. When the same sort of language was added for spousal travel, the IRS clarified in regulations that taxable spousal travel is still deductible.

Limitation of deduction by employers of expenses for entertainment and certain fringe benefits

The new law repeals deductions for entertainment, amusement, and recreation even when directly related to the conduct of a taxpayer's trade or business. The new law provides that no deduction is allowed for (1) an activity considered entertainment, amusement, or recreation, (2) membership dues for any club organized for business, pleasure, recreation, or other social purposes, or (3) a facility or portion of a facility used in connection with entertainment, amusement, or recreation.

The 50% deduction limitation for food and beverage expenses associated with a trade or business is generally retained. However, the provisions expand the 50% limitation to certain meals provided by an employer that previously were 100% deductible. The expanded 50% limit applies to food and beverages provided to employees as de minimis fringe benefits, to meals provided at an eating facility that meets the requirements for an on-premises dining facility, and to meals provided to employees under section 119 for the convenience of the employer. The 50% deduction limit applies for years after 2017 and before 2026. The on-premises meals and section 119 meals expenses and the expenses for the related on-premises facilities would be nondeductible after 2025.

The new law disallows any deduction expense of any qualified transportation fringe (as defined in the section 132(f) rules). Separately, the new law disallows the deduction for expenses to provide transportation or to reimburse for the expenses for commuting between the employee's residence and place of employment (unless the expenses are "necessary for ensuring the safety of an employee"). These costs appear to include employee buses, van pools, subway or transit cards, and qualified parking fees.

JCT has estimated this provision will increase revenue over 10 years by approximately \$23.5 billion for meals and entertainment expenses and \$17.7 billion for qualified transportation fringes.

Unrelated business taxable income increased by amount of certain fringe benefit expenses for which deduction is disallowed

The new law modifies the definition of unrelated business taxable income (UBTI) to include amounts paid or incurred by tax-exempt organizations in providing certain transportation fringe benefits (i.e., any qualified transportation fringe defined in section 132(f) and any parking facility used in connection with qualified parking defined in section 132(f)(5)(C)) and on-premises athletic facilities (defined in section 132(j)(4)(B)) if such benefits would be nondeductible (under section 274) if provided by taxable employers. The modification does not apply to the extent the amount paid or incurred is directly connected to an unrelated trade or business regularly carried on by the organization.

These changes apply to amounts paid or incurred after December 31, 2017.

The JCT estimate of the effects of this provision on revenue is included in the estimate above for the repeal of the deduction for qualified transportation fringes.

Repeal of deduction for local lobbying activities

The new law disallows the deduction for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments). The provision is effective for amounts paid or incurred on or after the date of enactment.

The JCT has estimated that this provision will raise approximately \$800 million over a 10-year period.

Deny deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment or sexual abuse

Taxpayers are generally allowed a deduction under section 162 for ordinary and necessary expenses incurred in carrying on any trade or business. However, there are certain exceptions to the general rule. For example, there is no deduction allowed for certain lobbying and political expenditures, illegal bribes, kickbacks or other illegal payments, and any fine or similar penalty paid to a government for the violation of any law. The new law imposes an additional exception, under which deductions would no longer be available for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement. The provision is effective for amounts paid or incurred on or after the date of enactment.

JCT has estimated that this provision will increase revenues by less than \$50 million over 10 years.

KPMG observation

The new law follows the House bill, and conforms in part to the disallowed deductions set forth in section 13304 of the new law, which disallows deductions for qualified transportation fringes (see “Limitation of deduction by employers of expenses for entertainment and certain fringe benefits,” discussed above). However, section 13304 does not appear to disallow a deduction for on-premises athletic facilities.

KPMG observation

The new law conforms the treatment of expenses for lobbying at the local level to the pre-enactment disallowance of such expenses for lobbying at other levels of government. Expenses associated with other common government affairs activities, such as monitoring legislation, attempts to influence rules and regulations, relationship building, and reputational lobbying at the local government level, are considered deductible as ordinary and necessary business expenses.

The provision included in the new law to repeal the deduction for local lobbying activities follows the Senate bill.

KPMG observation

The new law follows the provision in the Senate bill, without modification.



Accounting methods

Certain special rules for tax year of inclusion

Under the new law, accrual method taxpayers must recognize income no later than the tax year in which the item is recognized as revenue on an applicable financial statement (i.e., the all events test is satisfied no later than the year in which the revenue is recognized for financial accounting purposes). This book conformity requirement does not apply, however, either to an item of gross income earned in connection with a mortgage servicing contract, or to any item of gross income for which the taxpayer uses a special method of accounting provided under any other provision of the Code (such as, for example, long-term contracts under section 460 or installment agreements under section 453), except for the various rules for debt instruments contained in Subchapter P, Part V of the Code (sections 1271-1288: rules for original issue discount (OID), discount on short-term obligations, market discount, and stripped bonds and coupons).

In the case of a contract containing multiple “performance obligations,” the taxpayer must allocate the contract’s transaction price among the performance obligations for tax purposes in the same manner as the transaction price is allocated for financial accounting purposes.

Additionally, the new law codifies the deferral method of accounting for advance payment for goods and services provided by the IRS under Revenue Procedure 2004-34.

Finally, for holders of certain debt instruments with OID, the new law directs taxpayers to apply the revenue recognition rules under section 451 before applying the debt-specific rules such as the OID rules under section 1272. As a result, items included in income when received for financial statement purposes (e.g., late-payment and cash-advance fees) are generally includible in income at such time in accordance with the general recognition principles under section 451. The provisions related to OID apply to tax years beginning after December 31, 2018. The period for taking into account any adjustments under section 481 is six years if required by the amendments of the new law.

Other than the OID provisions, the other provisions related to the tax year of inclusion apply to tax years beginning after December 31, 2017, and application of these rules is a change in the taxpayer’s method of accounting for purposes of section 481.

The JCT has estimated that the special rules for tax year of inclusion will increase revenues by approximately \$12.6 billion from 2018-2027.

KPMG observation

The special rules for tax year of inclusion would cause an acceleration in the recognition of income for many taxpayers. For example, under the new law, any unbilled receivables for partially performed services must be recognized to the extent the amounts are taken into income for financial statement purposes, as opposed to when the services are complete or the taxpayer has the right to bill; advance payments for goods and revenue from the sale of gift cards are no longer deferred longer than one tax year; and income from credit card fees (such as late-payment, cash advance, and interchange fees) would generally be accelerated.

The new law should also be considered in relation to ASC 606, "Revenue from Contracts with Customers." In particular, tax departments would be required to coordinate with the company's financial accounting function to ensure that the transaction price of contracts containing multiple performance obligations (i.e., bundles of both goods and services) is allocated in the same manner for both book and tax purposes. This allocation may have consequences for both federal and state tax purposes.

One potentially problematic area that may arise under this provision involves accounting for manufacturing contracts. Under ASC 606, contract manufacturers will move from an inventory method to a progress measure in recognizing revenue and will no longer maintain inventories. Under the new law, contract manufacturers may be required to recognize revenue before the inventory is sold but continue to be required to maintain inventories and apply section 263A, assuming the contracts are not subject to the percentage of completion under section 460.

Whether the provision requires certain taxpayers to accelerate the accrual and recognition of market discount is unclear. Market discount arises when a taxpayer purchases a debt instrument on the secondary market at a discount to its principal amount (or its adjusted issue price in the case of a debt instrument with OID). The exception in

the provision for special methods of accounting provided under Chapter 1 of the Code specifically provides that it (the exception) does not apply to sections 1271 through 1288, which sections include not only the OID rules but also the market discount rules. On its face the provision, therefore, appears to apply to debt instruments with market discount. The explanatory statement in the conference report, however, states in a footnote that "the provision does not revise the rules associated with when an item is realized for Federal income tax purposes and, accordingly, does not require the recognition of income in situations where the Federal income tax realization event has not yet occurred." The footnote also states that "the provision does not 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 investment." Section 1276 generally provides that accrued market discount is treated as ordinary income to the extent of gain on the disposition of or receipt of any partial principal payment on any market discount bond, unless a taxpayer makes an election under section 1278(b) to include market discount in income as it accrues. Therefore, the market discount rules under section 1276 appear to require a realization event before a taxpayer must include market discount in income and accordingly it appears that such market discount rules come within the scope of the footnote stating that the provision does not revise the rules associated with when an item is realized for Federal income tax purposes. However, if instead the provision does apply to debt instruments with market discount and a taxpayer recognizes discount as it economically accrues in an "applicable financial statement" (as defined), then the favorable timing treatment under section 1276 may be limited.

The provision follows the Senate bill, without modifications.

Overall, these provisions allow businesses greater access to the cash method of accounting, and expand exceptions to the requirement to maintain inventories, the UNICAP rules, and the percentage of completion method.

The new law follows the House bill, without modifications.

Small business accounting

The new law includes several provisions (described below) to reform and simplify small business accounting methods. These provisions are effective for tax years beginning after December 31, 2017.

The JCT has estimated that the combined effect of these provisions would be a reduction in revenues by approximately \$30.5 billion over 10 years.

Increase threshold for cash method of accounting

Under pre-enactment law, with certain exceptions, a C corporation or partnership with a C corporation partner could use the cash method of accounting only if, for each prior tax year, its average annual gross receipts (based on the prior three tax years) do not exceed \$5 million. In addition, farm corporations and farm partnerships with C corporation partners could use the cash method of accounting if for each prior tax year their gross receipts do not exceed \$1 million (\$25 million for certain family farm corporations).

Under the new law, the threshold under the three-year average annual gross receipts test is increased to \$25 million (indexed for inflation for tax years beginning after 2018), and applies to all C corporations and partnerships with C corporation partners (other than tax shelters), including farming C corporations and farming partnerships. The three-year average test is applied annually under the legislation. A change to or from the cash method of accounting as a result of the provision is treated as a voluntary change in the taxpayer's method of accounting, subject to a section 481(a) adjustment.

Modify accounting for inventories

Under pre-enactment law, businesses that were required to use an inventory method must also use the accrual method of accounting for tax purposes. An exception from the accrual method of accounting is provided for certain small businesses if, for each prior tax year, the business's average annual gross receipts (based on the prior three tax years) do not exceed \$1 million. A second exception was provided for businesses in certain industries if, for each prior tax year, their average annual gross receipts (based on the prior three tax years) do not exceed \$10 million.

The new law permits additional businesses with inventories to use the cash method by increasing the threshold to \$25 million. Under the provision, a business with average annual gross receipts of \$25 million or less (based on the prior three tax years) is permitted to use the cash method of accounting even if the business has inventories. Under the provision, a business with inventories that otherwise qualifies for and uses the cash method of accounting is able to treat inventory as nonincidental materials and supplies or conform to its financial accounting treatment. A change to or from the cash method of accounting as a result of the provision is treated as a voluntary change in the taxpayer's method of accounting, subject to a section 481(a) adjustment.

Increase exemption for capitalization and inclusion of certain expenses in inventory costs

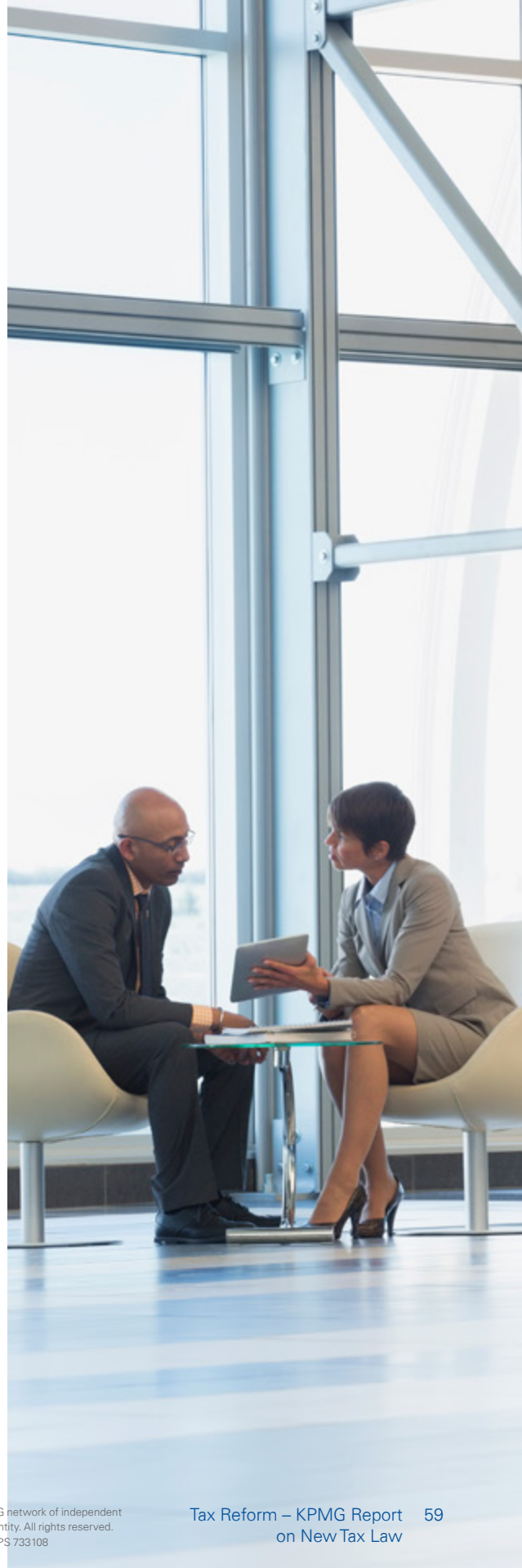
Under pre-enactment law, a business with \$10 million or less of average annual gross receipts for the prior three tax years was not subject to the uniform capitalization (UNICAP) rules with respect to personal property acquired for resale.

Under the new law, producers or resellers with average annual gross receipts of \$25 million or less (based on the prior three tax years) are fully exempt from the UNICAP rules. This exemption would apply to real and personal property for both resellers and manufacturers. A change in the treatment of section 263A costs as a result of the provision is treated as a voluntary change in the taxpayer's method of accounting, subject to a section 481(a) adjustment.

Increase exceptions for accounting for long-term contracts

The taxable income from a long-term contract generally is determined under the percentage-of-completion method. Under pre-enactment law, an exception to this requirement was provided for certain businesses with average annual gross receipts of \$10 million or less in the preceding three years. Under this exception, a business could use the completed contract method with respect to contracts that were expected to be completed within a two-year period.

Under the new law, the \$10 million average annual gross receipts exception to the percentage-of-completion method is increased to \$25 million. Businesses that meet the increased average annual gross receipts test are permitted to use the completed-contract method (or any other permissible exempt contract method). The provision applies to contracts entered after December 31 2017, in tax years ending after such date. A change in the taxpayer's method of accounting as a result of the provision is applied on a cutoff basis for all similarly classified contracts; thus there is no change, and no resulting section 481(a) adjustment, in the treatment of contracts entered into before January 1, 2018.



KPMG observation

The new law generally follows the Senate bill, with a reduced credit rate.

KPMG observation

The new law follows the Senate amendment with a modification to the transition rule for certain phased rehabilitations.

KPMG observation

The new law adopts the Senate bill's new general business credit for eligible employers without change.



Business credits

Modification of credit for clinical testing expenses for certain drugs for rare diseases or conditions

The new law limits the "orphan drug credit" to 25% of qualified clinical testing expenses for the tax year, and allows an election of reduced credit under section 280C.

The provision is effective for amounts paid or incurred in tax years beginning after 2017.

The JCT has estimated that the provision will increase revenue by \$32.5 billion over 10 years.

Modification of rehabilitation credit

The new law repeals the 10% credit for pre-1936 buildings and makes a modification to the 20% credit for certified historic structures, generally for amounts paid or incurred after 2017. Specifically, the credit for certified historic structures will remain at 20%, but must be claimed ratably over a five-year period beginning in the tax year in which a qualified rehabilitated structure is placed in service.

The new law includes a transition rule for qualified rehabilitation expenditures incurred with respect to either a certified historic structure or a pre-1936 building, with respect to any building owned or leased at all times on and after January 1, 2018, if the 24-month period selected by the taxpayer or the 60-month period selected by the taxpayer for phased rehabilitation, begins no later than the end of the 180-day period beginning on the date of the enactment of the Act. In such case, the modifications made to the rehabilitation credit provisions apply to such expenditures paid or incurred after the end of the tax year in which such 24-month or 60-month period ends.

The JCT has estimated that the provision will increase revenue by approximately \$3.1 billion over 10 years.

Employer credit for paid family and medical leave

The new law allows eligible employers to claim a credit equal to 12.5% of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave (FMLA) if the rate of payment under the program is 50% of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25%) for each percentage point by which the rate of payment exceeds 50%.

An eligible employer is one that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and that allows all less-than-full-time qualifying employees a commensurate amount of leave on a pro rata basis. A qualifying employee means any employee who has been employed by the employer for one year or more, and who for the preceding year, had compensation not in excess of 60% of the compensation threshold for highly compensated employees.

The new law also requires the Secretary to determine whether an employer or an employee satisfies applicable requirements based on employer-provided information as the Secretary determines to be necessary or appropriate.

The employer credit is generally effective for wages paid in tax years after 2017 and before 2020.

The JCT has estimated that the provision will decrease revenue by approximately \$4.3 billion over 10 years.



Miscellaneous business provisions

Qualified opportunity zones

The new law provides for the temporary deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and the permanent exclusion of capital gains from the sale or exchange of an investment held for at least 10 years in a qualified opportunity fund. A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in and holding at least 90% of its assets in qualified opportunity zone property. Qualified opportunity zone property includes any qualified opportunity zone stock, any qualified opportunity zone partnership interests, and any qualified opportunity zone business property.

The designation of a qualified opportunity zone is the same as the low-income community designation for the new markets tax credit. The certification of a qualified opportunity fund will be done by the Community Development Financial Institutions (CDFI) Fund, similar to the process for allocating the new markets tax credit.

The new law provides that each population census tract in each U.S. possession that is a low-income community is deemed certified and designated as a qualified opportunity zone effective on the date of enactment. The new law also clarifies that chief executive officer of the State (which includes the District of Columbia) may submit nominations for a limited number of opportunity zones to the Secretary for certification and designation. Finally, the new law clarifies that there is no gain deferral available with respect to any sale or exchange made after December 31, 2026, and there is no exclusion available for investments in qualified opportunity zones made after December 31, 2026.

The creation of qualified opportunity funds is effective on the date of enactment.

The JCT has estimated that the creation of qualified opportunity zones will decrease revenues by approximately \$1.6 billion over 10 years.

KPMG observation

These provisions were included in the Senate bill.

The Senate explanation for the amendments indicates that restrictions on the activities and assets of ANC Settlement Trusts may discourage contributions by ANCs; Settlement Trusts are an effective tool for reducing dependency upon welfare by Alaska Native communities; and policies designed to promote funding of Settlement Trusts improve the health, education, and welfare of Trusts' beneficiaries.

KPMG observation

The new law provides certainty on the issue of whether amounts paid to aircraft management service companies are taxable. In March 2012, the IRS issued a Chief Counsel Advice concluding amounts paid to aircraft management companies were generally subject to tax and the management company must collect the tax and pay it over to the government. The IRS began auditing aircraft management companies for this tax; however, it suspended assessments in May 2013 to develop further guidance. In 2017, the IRS decided not to pursue examination of this issue and conceded it in ongoing audits. No further guidance has been issued by the IRS to date.

Alaskan Native Corporation payments and contributions to settlement trusts

The new law modifies the tax treatment of Alaska Native Claims Settlement Act payments and contributions to settlement trusts. First, it permits Alaskan Native Corporations (ANCs) to assign certain payments to Settlement Trusts without recognizing gross income from the payments.

Second, it allows ANCs to elect annually to deduct contributions made to Settlement Trusts, subject to limitations. Generally the Settlement Trust must recognize income equal to the deduction allowable to the ANC. For contributions of property other than cash, the Settlement Trust takes a carryover basis in the property (or the fair market value of the property if less than the ANC's basis). The new law allows the Settlement Trust to elect to defer recognition of income associate with the contributed property until the time the Settlement Trust sells or disposes of the property.

Third, the new law requires that electing ANCs give the Settlement Trust a statement documenting details of contributions and such other information as the Secretary determines is necessary for the accurate reporting of income relating to contributions.

The first and third provisions are effective for tax years beginning after 2016. The provision for the deduction election is available for tax years still open for refund claims, with a one-year limitations period waiver for a period expiring within one year of enactment.

The JCT has estimated that the provision will decrease revenues by around \$100 million over 10 years.

Aircraft management services

Section 13822 of the new law amends section 4261 by exempting from the air transportation tax on persons or property payments for "aircraft management services" made by aircraft owners to management companies (related to the management of private aircraft). These payments relate to maintenance and support of the owner's aircraft or services related to flights on the owner's aircraft. Specifically, the payments for "aircraft management services" include administrative and support services such as scheduling; flight planning and weather forecasting; obtaining insurance; maintenance, storage, and fueling of aircraft; hiring, training, and provision of pilots and crew; establishing and complying with safety standards; and other services necessary to support flights operated by an aircraft owners.

The exemption applies to payments made by persons that lease aircraft, unless the lease is a "disqualified lease." Disqualified lease means a lease from a person providing aircraft management services for such aircraft if the lease term is 31 days or less.

The provision is effective for amounts paid after the date of enactment.

The JCT has estimated that the provision will decrease revenues by less than \$50 million over 10 years.

Expand nondeductibility of certain fines and penalties

Fines and penalties paid to a government are nondeductible for Federal income tax purposes under section 162(f). The new law further denies any otherwise deductible amounts paid or incurred to or at the direction of a governmental or specific nongovernmental regulatory entity for the violation or potential violation of any law. As under pre-enactment law, certain exceptions apply to payments established as restitution, remediation of property, or required for correction of noncompliance, as well as amounts paid or incurred as taxes due, but only if so identified in the court order or settlement agreement. Such exceptions do not apply to reimbursement of government investigative or litigation costs.

This provision is effective for amounts paid or incurred on or after the date of enactment, but would not apply to amounts paid or incurred under any binding order or agreement entered into before such date.

The JCT has estimated that this provision will increase revenues by approximately \$100 million over 10 years.

KPMG observation

The new law expands the definition of nondeductible fines and penalties to include certain payments for violations not made directly to the government. The new law follows the Senate bill, without modifications.



Department of the Treasury
Internal Revenue Service
Form 1120

Check if:
 Consolidated return

For calendar year
Name

U.S. Corporation
or tax year beginning on

Form 1120
Schedule J

Tax Computation (see page 20 of instructions)

Check if the corporation is a member of a consolidated group of corporations. If so, enter the name of the parent corporation and the consolidated return number.

Compensation

The new law does not include some compensation-related provisions that were in the House bill or Senate bill. For example, it does not include provisions relating to (1) reduction in minimum age for allowable in-service distributions; (2) modification of rules governing hardship distributions; (3) modification of rules relating to hardship withdrawals from cash or deferred arrangements; (4) modification of nondiscrimination rules to protect older, longer service participants; and (5) termination of deduction and exclusions for contributions to medical savings accounts.

The provisions described below are in the new law.



Modification of limitation on excessive employee remuneration

The new law expands the scope and repeals the exceptions to the section 162(m) \$1 million deduction limitation. The provisions expand the definition of “covered employee” to include the principal executive officer, principal financial officer, and the top three other highest-paid officers. Further, once an employee is treated as a covered employee, the individual remains a covered employee for all future years, including with respect to payments made after retirement, death, etc. The conference report’s explanatory statement provides that an individual who is a covered employee in a tax year beginning after December 31, 2016 remains a covered employee for future years.

The definition of a “publicly held corporation” is expanded to include all domestic publicly traded corporations and all foreign companies publicly traded through ADRs. Under the explanatory statement, the definition of public company may include some corporations that are not publicly traded, such as large private C or S corporations. However, the Code provisions do not appear to extend beyond SEC filers.

The new law provides a transition rule to the section 162(m) changes. Under this rule, the new provisions do not apply to any remuneration paid under a written, binding contract in effect on November 2, 2017, which was not materially modified on or after this date. The explanatory statement provides that compensation paid under a plan qualifies for this transition relief provided that the right to participate in the plan is part of a written, binding contract with the covered employee in effect on November 2, 2017, even if the covered employee was not actually a participant on November 2, 2017.

KPMG observation

The elimination of the exception for performance-based compensation from the \$1 million deduction limitation is a substantial change to the pre-enactment rules. The performance-based exception, while complex, was an often-used exception to link compensation to performance that could preserve a publicly held corporation's deduction for such compensation. The new law's expansion of the covered employee definition to include the principal financial officer in alignment with the definition used by the SEC has been a long discussed change as the differences in definitions generated some confusion. But, expanding the definition to apply even after officers terminate is also a major change that had not been expected. How the deduction limitation applies following a corporate transaction (acquisition, merger, etc.) or to services a former employee provides in another capacity, such as a nonemployee director, is unclear.

There are a number of open questions on the exact application of the transition rule.

The new law expands the definition of publicly held corporation to include any corporation required to file reports under section 15(d) of the Securities Exchange Act.

The explanatory statement provides an example of a grandfathered arrangement. The example includes a covered employee, newly hired and covered by an employment agreement in effect on October 2, 2017. The written employment contract provides that the employee was covered by the company's deferred compensation plan after six months of employment. The plan terms provide amounts payable under the plan are not subject to discretion, and the corporation does not have the right to amend materially the plan or terminate the plan, except prospectively before services are provided for an applicable period. It is noted that such payments would be grandfathered. The explanatory statement specifies that a plan in existence on November 2, 2017 is not by itself sufficient to meet the exception for binding, written contracts. Additionally, the statement clarifies that a contract that renews after November 2, 2017 is treated as a new contract on such renewal.

The provision is effective for tax years beginning after 2017.

The JCT has estimated the provision will increase revenues by approximately \$9.2 billion over 10 years.



Treatment of qualified equity grants

The new law allows certain employees to defer the timing of compensation for certain stock options and restricted stock unit (RSU) plans for private companies. Under this provision, if "qualified stock" is granted to a "qualified employee," then the employee may make an election within 30 days of vesting to have the tax deferred. In such case, the employee would have income the earliest of:

- The first date the stock is transferable
- The date the employee becomes an "excluded employee"
- The first date the stock becomes readily tradable on an established securities market
- The date that is five years after vesting, or
- The date the employee revokes the election.

This election would only be allowed on "qualified stock," which includes stock from the exercise of a stock option or the settlement of an RSU provided that the option or RSU was granted for the performance of services in a calendar year for which the corporation was an "eligible corporation." In order to be an eligible corporation, the stock of the company may not be readily tradable on an established securities market during any previous year. In addition, the company must have a written plan during the year and not less than 80% of all employees who provide services in the United States may be granted options and RSUs with the same rights and privileges. The 80% rule could not be satisfied in a year with a combination of options and RSUs. All employees must be granted stock options or RSUs. Stock would not be qualified stock if the employee can sell or receive cash in lieu of stock from the corporation at the time of vesting.

The election could not be made by an “excludable employee,” which includes:

- An individual who has been a 1% owner during the calendar year or was a 1% owner at any time during the last 10 years
- An employee who is or has at any time been the CEO or CFO or an individual acting in such capacity
- A person who is a family member of an individual described in the above two bullets, or
- A person who is one of the four highest compensated officers or has been one of the four highest compensated officers of the corporation in the 10 preceding tax years.

The election must be made by the employee within 30 days of vesting. The employer must provide the employee with notice of eligibility to make the election.

An election may not be made if the stock is readily tradable on an established securities market, or the company has purchased outstanding stock in the prior year (unless at least 25% is deferral stock and the individuals eligible to participate were determined on a reasonable basis).

A qualified employee would be allowed to make an election on qualified stock from a statutory option, but the option would no longer be treated as a statutory option. Further, the option would be treated as a nonqualified stock option for FICA withholding purposes.

The new law specifies that section 83 does not apply to RSUs, except for the section 83(i) election. RSUs are not eligible for section 83(b) elections.

The election would be valid only for income tax purposes and would not change FICA and FUTA timing. In the tax year the income is ultimately required to be included in the employee’s income as wages, the employer would be required to withhold at the highest individual income tax rate. The employer would be required to report the amount of the election deferral on the Form W-2 in both the year of the election and the year the deferral is required to be included in income. Also, the employer would be required to report annually on the Form W-2 the aggregate amount deferred under such an election.

As part of a transition period and until additional guidance is provided, the new law provides that a company is in compliance with both the 80% rule and the notice requirements so long as the company complies with a “reasonable and good faith” interpretation of the requirements.

The provision is effective for options exercised, or RSUs settled, after December 31, 2017.

The JCT has estimated that the provision will decrease revenues by approximately \$1.2 billion over 10 years.

KPMG observation

This provision may have been added to assist private companies that give broad groups of employees equity compensation but have no market for the shares. The exercise of the options or transfer of the stock in private companies with no liquidity generally results in illiquid income with federal and state withholding requirements. Note that the deferral is limited to 5 years and will result in illiquid income if company shares are not liquid within that period.

There are also questions about whether the employer must opt into the program or whether it is automatic in situations that satisfy the provisions in light of the penalty for failing to give employees notice when there is an opportunity to defer under this provision.



Excise tax on excess tax-exempt organization executive compensation

The new law imposes an excise tax equal to the corporate tax rate (21%) on remuneration in excess of \$1 million and on excess parachute payments paid by an organization exempt from tax under section 501(a), an exempt farmers' cooperative (section 521(b)(1)), a political organization (section 527), or a state or local governmental entity with excludable income (section 115(1)), to any of its current or prior (beginning after December 31, 2016) five highest-paid employees.

Remuneration includes cash and other benefits paid in a medium other than cash and is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration. However, it does not include any designated Roth contribution (section 402A(c)), amounts that are excludable from gross income, or payments to licensed medical professionals (e.g., doctors, nurses, or veterinarians) for the performance of medical or veterinary services. Remuneration would also include payments from certain related organizations, including organizations that control, or are controlled by, the tax-exempt organization. However, remuneration that is not deductible by reason of the \$1 million limit on deductible compensation (section 162(m)) is not taken into account for purposes of the provision.

A "parachute payment" generally is defined as a payment contingent upon an employee's separation from employment if the aggregate present value of such payment equals or exceeds three times the employee's base amount. Parachute payments do not include payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity (section 403(b)), or an eligible deferred compensation plan of a state or local government or tax-exempt organization (section 457(b)). Further, parachute payments do not include payments to licensed medical professionals for the performance of medical or veterinary services or to individuals who are not highly compensated employees under section 414(q). The excise tax is applied to the excess of the parachute payment over the portion of the base amount allocated to the payment.

The provision applies to remuneration and parachute payments paid in tax years beginning after December 31, 2017 (though it would define covered employees in tax years beginning after December 31, 2016).

The JCT has estimated the provision will increase revenues by approximately \$1.8 billion over 10 years.

KPMG observation

The new law follows the Senate bill with some modifications:

- Determining the excise tax by reference to the corporate rate (rather than as a fixed percentage)
- Defining substantial risk of forfeiture by reference to section 457(f)(3)(B)
- Exempting payments to non-highly compensated employees (as defined in section 414(q)) from the definition of parachute payment
- Excluding remuneration paid to a licensed medical professional (e.g., doctor, nurse, or veterinarian) for the performance of medical or veterinary services

Specifically, the new law provides rules for tax-exempt entities that are similar to section 162(m) limits on the deductibility of compensation paid by publicly traded corporations, but it does not incorporate a transition rule similar to that included in the changes to section 162(m), under which remuneration paid pursuant to a written binding contract in effect on November 2, 2017, is excluded from the new rule, so long as the agreement is not later modified.

The new law also provides rules for tax-exempt entities that are similar to section 280G rules on excess parachute payments that may be applicable to taxable corporations. The provision related to “excess parachute payments” relies upon section 280G guidance for determining the “base amount” calculation.

By excluding remuneration directly related to the provision of medical services, the new law may help alleviate concerns of tax-exempt hospitals that commonly pay certain specialist physicians more than \$1 million.

The provision imposes the excise tax on the employer and related organizations, each sharing the liability in proportion to the compensation paid. As a result of the provision’s broad definition of related organizations, it appears that a taxable organization could be subject to the excise tax.

The provision adds an additional layer of complexity to the rules governing compensation paid by tax-exempt organizations. Sections 4941 and 4958 impose excise taxes on the recipients of unreasonable or excess compensation paid by certain tax-exempt organizations. In addition, the inurement prohibition that applies to most tax-exempt organizations, the violation of which may result in loss of tax-exempt status, guards against the payment of unreasonable compensation. The provision appears to not take into account some of these existing rules.



Retirement savings

KPMG observation



Repeal of special rule permitting recharacterization of IRA contributions

The new law provides that the special rule allowing contributions to one type of IRA to be recharacterized as a contribution to the other type of IRA does not apply to a conversion to a Roth IRA. The new law provides that a conversion contribution to a Roth IRA during a tax year may no longer be recharacterized as a contribution to a traditional IRA and unwinding the conversion. Recharacterization is still be permitted for other contributions. This provision does not prohibit a contribution to an IRA and a conversion to a Roth IRA.

The effective date is for tax years beginning after December 31, 2017.

The JCT has estimated the provision will increase revenues by approximately \$500 million over 10 years



Extended rollover period for the rollover of plan loan offset amounts

The new law extends the period allowed for a qualified plan loan offset amount to be contributed to an eligible retirement plan as a rollover contribution from 60 days to the due date, including extensions, for filing the Federal income tax return for the tax year the loan offset occurs. This extension would apply to a qualified plan loan offset amount distributed from a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan solely because of a termination of the plan or the failure to meet the repayment terms because of a severance from employment.

The effective date is for plan loan offsets amounts treated as distributed in tax years beginning after December 31, 2017.

The JCT has estimated the provision would have negligible revenue impact over 10 years.



Modification of rules for length of service award plans

The new law provides an increased aggregate amount of length of service awards under the section 457 exemption that may accrue for a bona fide volunteer to any year of service to \$6,000 with an annual cost of living adjustment after the first year. If the plan is a defined benefit plan, the limit applies to the actuarial present value of the aggregate amount of length of services awards accruing to any year of service.

The effective date is for tax years beginning after December 31, 2017.

The JCT has estimated that the provision will decrease revenues by approximately \$500 million over 10 years.

The pre-enactment rules only allowed an employee 60 days to pay the qualified loan offset amount to an IRA or retirement plan upon termination of employment or the loan is treated as a distribution. The new law provides an employee with additional time to contribute the loan offset amount before it is characterized as a taxable distribution.



Passthrough entities and sole proprietorships



Treatment of business income and loss of certain noncorporate taxpayers

Deduction of 20% for certain passthrough income (subject to sunset)

For tax years beginning after December 31, 2017 (subject to a sunset at the end of 2025), the new law generally allows an individual taxpayer (and a trust or estate) a deduction for 20% of the individual's domestic qualified business income from a partnership, S corporation, or sole proprietorship. However, the deduction generally is subject to a limit based either on wages paid or wages paid plus a capital element. Specifically, the limitation is the greater of (i) 50% of the wages paid with respect to the qualified trade or business; or (ii) the sum of 25% of the W-2 wages with respect to the qualified trade or business plus 2.5% of the unadjusted basis (determined immediately after an acquisition) of all qualified property.

Qualified property means tangible property of a character subject to depreciation that: (i) is held by, and available for use in, the qualified trade or business at the close of the tax year; (ii) is used at any point during the tax year in the production of qualified business income; and (iii) for which the depreciable period has not ended before the close of the tax year. For this purpose, the "depreciable period" with respect to qualified property means the period beginning on the date the property is placed in service by the taxpayer and ending on the later of: (i) 10 years after that date; or (ii) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (without regard to section 168(g)).

A taxpayer's "W-2 wages" generally equals the taxpayer's share of the sum of wages subject to wage withholding, elective deferrals, and deferred compensation paid by the partnership, S corporation, or sole proprietorship during the tax year. In the case of a trust or estate, rules similar to Code section 199 (as in effect on December 1, 2017) would apply for purposes of apportioning between fiduciaries and beneficiaries any W-2 wages and unadjusted basis of qualified property. The 50% of wages limitation would not apply in the case of a taxpayer with income of \$315,000 or less for married individuals filing jointly (\$157,500 for other individuals), with phase-out over the next \$100,000 of taxable income for married individuals filing jointly (\$50,000 for other individuals), subject to inflation adjustments.

With certain exceptions described below, an individual's qualified business income for the tax year is the net amount of domestic qualified items of income, gain, deduction, and loss (determined by taking into account only items included in the determination of taxable income) with respect to the taxpayer's "qualified business." If the amount of qualified business income for a tax year is less than zero (i.e., a loss), the loss is treated as a loss from qualified businesses in the next tax year.

A qualified business generally is any trade or business other than a "specified service trade or business." A specified service trade or business is any trade or business activity involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services; any trade or business the principal asset of which is the reputation or skill of one or more of its owners or employees (excluding engineering and architecture); or any business that involves the performance of services that consist of investment and investment managing trading or dealing in securities, partnership interest, or commodities. However, the deduction may apply to income from a specified service trade or business if the taxpayer's taxable income does not exceed \$315,000 (for married individuals filing jointly or \$157,500 for other individuals). Under the new law, this benefit is phased out over the next \$100,000 of taxable income for married individuals filing jointly (\$50,000 for other individuals).

Twenty percent (20%) of any dividends from a real estate investment trust (other than any portion that is a capital gain dividend or qualified dividend income) are qualified items of income, as are 20% of includible dividends from certain cooperatives and qualified publicly traded partnership income. However, qualified business income does not include certain service related income paid by an S corporation or a partnership. Specifically, qualified business income does not include an amount paid to the taxpayer by an S corporation as reasonable compensation. Further, it does not include a payment by a partnership to a partner in exchange for services (regardless of whether that payment is characterized as a guaranteed payment or one made to a partner acting outside his or her partner capacity). Finally, qualified business income does not include certain investment related gain, deduction, or loss.

The 20% deduction is not allowed in computing adjusted gross income; instead, it is allowed as a deduction reducing taxable income. Thus, the deduction does not affect limitations based on adjusted gross income. Moreover, the deduction is available to taxpayers that itemize deductions, as well as those that do not.

The new law also provides a similar deduction for specified agricultural or horticultural cooperatives.

The provision is effective for tax years beginning after December 31, 2017. Importantly, however, the 20% deduction does not apply to tax years beginning after December 31, 2025 – i.e., the deduction is temporary unless legislation is enacted extending it.

The JCT has estimated that that the 20% deduction will decrease revenue by approximately \$415 billion over a 10-year period.

KPMG observation

The 20% deduction for certain passthrough income was largely modeled on a Senate bill provision, but was modified in several respects, including extending the deduction's availability to trusts and estates.

The conference report's explanatory statement provides that the deductible amount for each qualified trade or business is determined first. The combined qualified business income amount for the tax year is the sum of the deductible amounts determined for each qualified trade or business and 20% of the taxpayer's qualified REIT dividends and publicly traded partnership income (assuming no qualified cooperative dividends). The taxpayer's deduction for qualified business income is then generally equal to the sum of (a) the lesser of the combined qualified business income or an amount equal to 20% of the excess of the taxpayer's taxable income over any net capital gain. The determinations of what is a trade or business and what constitutes a specified service trade or business (for instance in the context of the field of health) will be important for purposes of applying the new rules.

A taxpayer would also need to determine to what extent the taxpayer has wages with respect to a trade or business for purposes of determining the limitation for each trade or business. Further, the definition of "W-2 wages" in the new law appears to provide different results for taxpayers that operate a business in an S corporation than for taxpayers that operate as a partnership or sole proprietorship. Wages paid by an S corporation to its owners are W-2 wages, but an equivalent payment made by a partnership or a sole proprietorship to an owner is not.

The addition of the ability to look to 25% of the W-2 wages plus 2.5% of the unadjusted basis (determined immediately after acquisition) of all qualified property for purposes of the limitation on the deduction provides relief for capital intensive businesses which traditionally have not reported wages at the entity level, such as real estate. It is worth noting that qualified property appears to include property acquired prior to the date of enactment and does not require reduction for depreciation under section 168(k).

In addition, the new law may provide a different result for the sale of an interest in a publicly traded partnership than that provided for sale of a nonpublicly traded partnership. Specifically, the definition of "qualified publicly traded partnership income" includes any gain recognized on the sale of an interest in a publicly traded partnership to the

extent that gain is characterized as ordinary income under section 751. Under this rule, recapture of items of deduction that reduced qualified business income in prior years is taxed at the qualified business rate. That seems to be correct from a policy perspective. However, it is unclear whether that would be the case if a taxpayer sells an interest in a nonpublicly traded partnership.

The new law directs the Treasury to provide regulations applying the rules for requiring or restricting the allocation of items and wages and such reporting requirements as Treasury determines are appropriate. Further, the new law directs the Treasury to provide regulations (1) applying the provision to tiered entities, and (2) applying the rules in short tax years and years during which the taxpayer acquires or disposes of the major portion of a trade or business or the major portion of a separate unit of a trade or business. In addition, the new law adds the requirement for anti-abuse rules with respect to the manipulation of the depreciable period of qualified property using transactions between related parties and for determining the unadjusted basis of qualified property following a like-kind exchange or involuntary conversion.

The new law provides that qualified business income that is passive income may not benefit from the 20% deduction for purposes of the net investment income tax. As a consequence, liability for the net investment income tax may be unchanged by the provisions intended to benefit businesses conducted through passthrough entities.

The 20% deduction is allowed as a deduction in reducing taxable income. As such, it would be taken into account at the partner or shareholder level. Thus, absent amendment, many partnership agreements and shareholder agreements might not take into account the deduction for purposes of determining partnership tax distributions that might be made starting with the first quarter of 2018. Both the 20% deduction and the 21% corporate tax rate could affect the amount required to be distributed and enhance the cash flow of the partnership or S corporation.

Perhaps most importantly, the 20% deduction in the new law expires after eight years. In contrast, the corporate tax reduction in the law is permanent. This and other differences should be considered by taxpayers considering whether to continue to operate business in passthrough form (rather than as a corporation) as a result of the large decrease in corporate tax rates.

The new law effectively denies business deductions for taxpayers (other than C corporations) for any net business losses in excess of \$250,000 (or \$500,000 in the case of a joint return). To the extent the loss exceeds the threshold amount, it would become part of the taxpayer's NOL and carried forward under section 172 to subsequent years. Although not specifically stated in the statute, to the extent the loss does not exceed the threshold amount but exceeds the taxpayer's other income, it appears that it would also become part of the taxpayer's NOL. Thus, taxpayers may be surprised to find that business losses above the limit that are no longer suspended as passive activity losses are nevertheless unavailable to offset other income and must be carried forward as an NOL. However, it appears that in the subsequent year, 80% of such losses would be available as an NOL and would not be subjected again to limitation under section 461(l).

In addition, the new law may affect a taxpayer in the farming business that has a "very bad year" after several good years. Under pre-enactment law, the taxpayer was able to take into account income in its profitable years to increase the amount of its deduction from farming activities in the bad year. The new loss limitation rule would prevent this during the period it is in effect.

Loss limitation rules for taxpayers other than C corporations (subject to sunset)

The new law includes provisions that expand certain limitations on losses for noncorporate taxpayers for tax years beginning after December 31, 2017, and before January 2, 2026. Specifically, the law makes sections 461(j) (relating to excess farm losses) inapplicable and establishes a new loss limitation for all noncorporate taxpayers.

Under pre-enactment law, section 461(j) limited the use of an excess farm loss incurred by a taxpayer (other than a C corporation) that receives an applicable subsidy. Generally, an excess farm loss could be deducted, but only to the extent of the greater of: (i) \$300,000 (\$150,000 in the case of a married taxpayer filing a separate return); or (ii) the taxpayer's total net farm income for the five preceding tax years. Any excess loss would be carried forward and treated as a deduction in the following tax year.

The new law contains a significant change to the treatment of business losses of taxpayers other than C corporations. Under section 461(l) of the new law, any "excess business loss" of the taxpayer (other than a C corporation) is not allowed. For purposes of this rule, an "excess business loss" is an overall loss in excess of \$500,000 for married individuals filing jointly or \$250,000 for others individuals. Any business loss in excess of such threshold amount is treated as part of the taxpayer's net operating loss (NOL) and carried forward to subsequent tax years. These NOL carryforwards are governed by section 172.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Thus, each partner's or shareholder's share of the items of the entity is taken into account in calculating the partner or shareholder's limitation.

The provision applies after application of the passive loss rules of section 469.

The provision generally is effective for tax years beginning after December 31, 2017, but expires after December 31, 2025. The JCT has estimated that the changes to the loss limitation rules will increase revenue by approximately \$149.7 billion over a 10-year period.

Tax gain on the sale of a partnership interest on look-through basis

The new law amends section 864(c) to treat gain or loss on a sale of a partnership interest as effectively connected with a U.S. trade or business to the extent that a foreign corporation or foreign individual that owns the partnership interest (whether directly or indirectly through other partnerships) would have had effectively connected gain or loss had the partnership sold its underlying assets.

In 1991, the IRS issued Rev. Rul. 91-32,⁶ which much like the current provision held that a foreign partner's capital gain or loss on the sale of a partnership interest is properly treated as effectively

⁶ 1991-1 C.B. 107.

connected with a U.S. trade or business if and to the extent that a sale of the underlying assets by the partnership would have resulted in effectively connected income for the foreign partner. In 2017, the Tax Court refused to follow the revenue ruling in determining that a foreign partner was not subject to U.S. tax on a sale of a partnership interest (to the extent the gain was not attributable to U.S. real property interests).⁷

The new law adopts a look-through rule somewhat similar to that provided in section 897(g)⁸ to the sale of all partnership interests, not just those that hold U.S. real property interests. Specifically, the new law provides that gain or loss from the sale, exchange, or other disposition of a partnership interest is effectively connected with a U.S. trade or business to the extent that a partner that is a foreign individual or foreign corporation would have had effectively connected gain or loss if the partnership had sold all of its assets at fair market value on the date of the exchange. For this purpose, the gain or loss from the hypothetical asset sale by the partnership is allocated to interests in the partnership in the same manner as nonseparately stated items of income or loss. The amount of the gain or loss treated as effectively connected income under the provision is reduced by the amount so treated with respect to U.S. real property interests under section 897. While the provision applies to gain or loss from the sale, exchange, or other disposition of the partnership interest, it gives broad regulatory authority to determine the appropriate application of the provision, including to various corporate nonrecognition transactions, such as contributions, liquidations, and reorganizations.

The new law also requires that the transferee of a partnership interest withhold 10% of the amount realized on a sale or exchange of the interest unless the transferor certifies that it is not a foreign person and provides a U.S. taxpayer identification number. Such a transferee must withhold if it has knowledge or is notified that the affidavit is false, or if the transferee fails to provide the Service with a copy of the transferor's affidavit in the manner required by regulations. If the transferee fails to withhold the correct amount, the new law imposes an obligation on the partnership to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold, plus interest.

The new law gives the Service authority to prescribe a reduced amount of withholding in situations where it determines that such reduced amount will not jeopardize the collection of tax on gain treated as effectively connected under section 864(c)(8).

The JCT has estimated that the provision will increase revenues by approximately \$3.8 billion over a 10-year period.

The substantive tax provision applies to transfers occurring on or after November 27, 2017; however, the withholding tax obligation only applies to transfers occurring after December 31, 2017.

⁷ *Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner*, 149 T.C. No. 3 (July 2017).

⁸ Section 897(g), part of the Foreign Investment In Real Property ("FIRPTA") Tax Act, sources gain on the sale of a partnership interest as U.S. sourced to the extent consideration is received that is attributable to U.S. real property interests held, directly or indirectly, by the partnership.

KPMG observation

This provision is based on the Senate bill with modifications. The characterization of gain or loss on the sale or exchange of the partnership interest as effectively connected in whole or in part is similar to the rules under section 897(g) in looking through to partnership assets to determine the amount of effectively connected gain or loss. However, unlike section 897, section 864(c)(8) does not explicitly override nonrecognition provisions. Rather, broad regulatory authority is given to determine the appropriate application of the substantive tax provision for a number of corporate nonrecognition transactions. Hopefully, such guidance will address the application to partnership nonrecognition transactions, such as contributions or distributions and mergers and divisions.

This provision affects foreign partners of partnerships engaged, directly or indirectly through one or more partnerships, in a U.S. trade or business, including partners in various fund structures. Partnerships, whether U.S. or foreign, that transfer such interests are required to treat the appropriate amount of gain or loss as effectively connected to a U.S. trade or business and withhold on this amount with respect to any foreign partner under section 1446.

The reason for the requirement to allocate gains on a hypothetical sale of assets in the same manner as nonseparately stated income or loss is unclear. The new law does not define “nonseparately stated items” for purposes of this provision. That term possibly could be describing the partnership’s net income or net loss remaining after all items required by section 702(a) to be separately stated are removed, which includes the removal of capital gains and losses and any item that, if separately taken into account by any partner, would result in a differing income tax liability for the partner if not separately stated. Practitioners colloquially use the term to describe net operating income. Of note, the conference report indicates that the use of “nonseparately stated taxable income or loss of the partnership” for purposes of section 163(j) is the ordinary business income or loss reflected on Form 1065 (U.S. Return of Partnership Income), and a partner’s distributive share of this amount is reflected in Box 1 of Schedule K-1. If the intent of the provision is to use the sharing ratios for operating income, similar to the use in section 163(j), the determination of the amount of gain that is effectively connected seemingly does not make sense. Partnerships often have different sharing ratios in operating income and gains from the sale of assets used in the trade or business. As such, using the ratio of nonseparately stated income to determine the amount of gain or loss on the sale of a partnership interest that is effectively connected with a U.S. trade or business could yield different results from the effectively connected gains or losses allocated to a partner from an actual sale of assets by the partnership that is determined pursuant to the partnership agreement provisions.

The provision requires that gain from the sale, exchange, or other disposition of the interest is treated as effectively connected with the conduct of a U.S. trade or business to the extent it does not exceed the portion of the partner’s distributive share of effectively connected gain from a hypothetical sale of partnership assets. As such, the provision appears to limit effectively connected gain to the gain realized from the exchange of the partnership interest. This result appears to differ from the result under section 751(a) which can result in more ordinary “hot asset” income than the gain otherwise realized

on the exchange of the partnership interest. Accordingly, where the partnership holds both appreciated effectively connected assets, and depreciated non-effectively connected assets, it appears that not all of the foreign partner’s effectively connected gain, as determined on a look-through basis, would be recognized under the provision. A similar provision is provided with respect to effectively connected loss from the exchange.

The withholding provision imposed on transferees applies to transfers of partnership interests where a foreign partner’s gain on the disposition of the interest would be effectively connected gain. It appears that the withholding provisions apply to nonrecognition exchanges. The withholding regime differs from the withholding regime imposed under section 1445 with respect to the sale or exchange of an interest in a partnership that holds U.S. real property interests, not only as to the rate (15% under section 1445), but also, unlike the rules under Reg. sec. 1.1445-11T(b) and (d), under new section 1446(f)(1), in that the only explicit exception from 10% withholding is if the transferor certifies it is not a foreign person, although the IRS is given latitude to provide for reduced withholding and additional exceptions in appropriate circumstances. Note further that the withholding regime applies to transferees where the transferor is a foreign partnership, or other foreign person, so that withholding could be required both under section 1445 (at a 15% rate) and under new section 1446(f) (at a 10% rate) on the transfer of the same partnership interest, and there yet there still remains an obligation to withhold by the foreign partnership under section 1446(a) with respect to its foreign partners. Without additional exceptions or coordination, duplicative or over-withholding could result.

Finally, the provision also differs from the section 1445 regime in that an obligation is imposed on the partnership to withhold on distributions to the transferee in an amount that the transferee failed to withhold, plus interest. The new law does not indicate the applicable rate of interest or the due date of the deposit (which determines when the liability for interest begins). This puts an onus on the partnership to determine whether there was sufficient withholding, and in some cases could raise questions as to what the amount realized was on which withholding should have been done (in cases of nonrecognition transfers, for example).



Modification of the definition of substantial built-in loss in the case of transfer of partnership interest

The new law modifies the definition of a substantial built-in loss for purposes of section 743(d).

Under pre-enactment law, if the partnership has a substantial built-in loss in its property, it must decrease the adjusted basis of partnership property (with respect to the transferee partner) by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of his interest in the partnership (mandatory section 743(b) adjustment). The rules determine whether there is a substantial built-in loss at the partnership level, comparing the partnership's adjusted basis in partnership property to the fair market value of its property. If the adjusted basis of all partnership property exceeds the fair market value by more than \$250,000, then the partnership is considered to have a substantial built-in loss and the mandatory section 743(b) adjustment is required to reduce the basis of the partnership assets with respect to the transferee. The purpose of the rule is to prevent the duplication of losses, once by the transferor partner upon the sale of his interest and a second time by the transferee upon the partnership's sale of the partnership property for other than small losses.

The new law modifies the definition of a substantial built-in loss to add a rule that focuses on a partner-level determination, to further ensure that losses are not duplicated. The additional definition looks to whether the transfer of the interest has the effect of transferring a loss in excess of \$250,000 to the transferee, rather than just whether the partnership has an overall loss in its assets. Thus, even if the partnership has an overall gain upon the sale of all of its assets, if the transferee would be allocated more than \$250,000 in losses, as a result of its share of gain or loss with respect to particular assets, a mandatory section 743(b) adjustment would be required. Specifically, the new rule provides that a substantial built-in loss exists if the transferee would be allocated a net loss in excess of \$250,000 upon a hypothetical sale of all the partnership's assets in a fully taxable transaction for cash equal the assets' fair market value, immediately after the transfer of the partnership interest.

The JCT has estimated that the provision will raise approximately \$0.5 billion over a 10-year period.

The changes apply to tax years beginning after December 31, 2017.

KPMG observation

This provision can be expected to create additional compliance issues, requiring a partnership to calculate whether it has a substantial built-in loss both at the partnership and the transferee partner level.

While the conference report's explanatory statement acknowledges that the IRS has taken the position that section 704(d) does not apply to a partner's distributive share of a partnership's charitable contributions (see Private Letter Ruling 8405084), it indicates that the exclusion of such contributions (and foreign taxes) from the section 704(d) limitation is not appropriate.

The modification in the new law generally is consistent with rules that limit an S corporation shareholder's losses and deductions to its tax basis in the S corporation's stock and debt, taking the shareholder's pro rata share of the S corporation's charitable contributions and foreign taxes into account.

This provision was in the Senate bill but not the House bill.



Partnership charitable contributions and foreign taxes taken into account in determining partner loss limitation under section 704(d)

The new law provides that a partner's distributive share of a partnership's charitable contributions and foreign taxes paid or accrued is taken into account for purposes of determining the partner's loss limitation under section 704(d).

In the case of a charitable contribution of property in particular, the amount of a partner's section 704(d) limitation is reduced by the partner's distributive share of the partnership's tax basis in the property. If a partnership makes a charitable contribution of appreciated property, section 704(d) does not apply to the extent that the value of the property exceeds its tax basis.

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will increase revenues by approximately \$1.2 billion over 10 years.



Short-term capital gain with respect to applicable partnership interests

Section 13309 of the new law adds to the Code a new section 1061 addressing the taxation of "applicable partnership interests." The new provision is identical to the applicable partnership interest provision contained in the Senate bill. Under the provision, if one or more "applicable partnership interests" were held by a taxpayer at any time during the tax year, some portion of the taxpayer's long-term capital gain with respect to those interests would be treated as short-term capital gain. At a high level, the provision requires that, to obtain long-term capital gain treatment for applicable partnership interests, the required asset-holding period must be greater than three years.

New Code section 1061 applies only with respect to "applicable partnership interests." To qualify as such, the partnership interest has to be transferred to, or held by, the taxpayer in connection with the performance of substantial services by the taxpayer (or a related person) in any "applicable trade or business." An "applicable trade or business" is an activity that is conducted on a regular, continuous, and substantial basis and that consists (in whole or in part) of (1) raising or returning capital; and (2) either (a) investing in or disposing of "specified assets" (or identifying such specified assets for investing or disposition), or (b) developing specified assets. "Specified assets" include securities, commodities, real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to the forgoing assets, or an interest in a partnership to the extent of the partnership's interest in the forgoing assets.

Two exceptions may apply to exclude treatment of certain partnership interests as applicable partnership interests. First, an applicable partnership interest does not include a partnership interest held by a corporation. Second, an applicable partnership

interest does not include a capital interest that provides the partner with a right to share in partnership capital commensurate with (1) the amount of capital contributed (determined at the time of receipt of the partnership interest); or (2) the value of the interest included in income under section 83 upon receipt or vesting. This exception appears intended to allow a service partner to earn income as long-term capital gain under the normal rules with respect to a partnership interest received in exchange for contributed capital or to the extent the partner included the value of the interest in income under section 83.

To the extent provided by the Secretary, the three-year holding period in section 1061 does not apply to income or gain attributable to any asset not held for portfolio investment on behalf of “third-party investors.” A third-party investor for this purpose is a person who (1) holds an interest in the partnership that is not held in connection with an applicable trade or business; and (2) is not and has not been actively engaged (and is not and was not related to a person so engaged) in (directly or indirectly) providing substantial services related to an applicable trade or business to the partnership or any applicable trade or business. This provision appears to be aimed at the “enterprise value” issue and seems to direct the Secretary to promulgate regulations that exclude gain from the intangible asset value associated with a sponsor’s investment management business from the application of the new rules.

New Code section 1061 would provide that, upon the transfer of an applicable partnership interest to a related person, the transferor must include short-term capital gain equal to the excess of (1) the taxpayer’s long-term capital gain with respect to such interest for such tax year attributable to the sale or exchange of any asset held for not more than three years as is allocable to such interest; over (2) any amount already treated as short-term capital gain under the primary provision with respect to the transfer of such interest. For this purpose, a related person includes only persons with a family relationship under section 318(a)(1) and persons who performed services in the current calendar year or the prior three calendar years in any applicable trade or business in which or for which the taxpayer performed any service. This provision appears to be aimed at assignment of income issues, although the provision is drafted in a manner that makes it difficult to determine its exact effect.

The new law provides that short-term capital gain treatment applies under section 1061 “notwithstanding section 83 or any election in effect under section 83(b).”

New section 1061 provides authority for the issuance of such regulations or other guidance as are necessary to carry out the purposes of the provision. The provisions covered by the amendment are effective for tax years beginning after December 31, 2017. The new law does not include rules “grandfathering” applicable partnership interests held as of the effective date of such legislation.

The JCT has estimated that this provision will raise approximately \$1.1 billion over a 10-year period.

KPMG observation

The new section appears intended to address the long-debated tax treatment of carried interests. Various bills have been proposed relating to this issue. The new law has some similarities to those proposals, but a great many differences.

Although not entirely clear, it appears that the three-year holding period described in the bill would be required for sales of assets held (directly or indirectly) by the applicable partnership, or, in the case of the sale of an applicable partnership interest, the applicable partnership interest itself. Rather than treating amounts failing the three-year test as ordinary income (as has been the typical recharacterization under prior versions of proposed carried interest legislation), section 1061 treats such gain as short-term capital gain.

Significantly, the new section operates only by modifying the application of sections 1222(3) and (4) and requiring a holding period for “capital assets” of more than three years in order to recognize long-term capital gain or loss. The Code contains a number of other provisions, such as section 1231, which result in taxation of gain recognized at long-term capital gain rates without reference to section 1222. Read literally, the new section appears not to impact the application of those provisions, even

with respect to assets held for three years or less. On the other hand, the Code also contains provisions, like the REIT capital gain dividend rule in section 857(b)(3)(B), which provide for long-term capital gain treatment by characterizing the relevant income as gain from the sale or exchange of a capital asset “held for more than 1 year.” By virtue of such a provision, long-term capital gain treatment generally would result under section 1222(3). Under a strict reading of section 1061, there is concern that REIT capital gain dividend income allocated to an applicable partnership interest never could satisfy the three-year threshold even if the REIT held the asset generating the relevant gain for significantly longer than three years, since section 857(b)(3)(B) deems the gain to result from the sale or exchange of an asset held only for more than one year.

The exception for applicable partnership interests held by a corporation resolves significant controversy that arose in connection with earlier versions of carried interest legislation as a result of subjecting corporations (which were not rate sensitive) to the complexities and other issues associated with carried interest proposals. The new law resolves this controversy by simply excluding corporations that hold partnership interests from the new rules. Questions have arisen as to whether the reference to a “corporation” for these purposes includes an S corporation.

The provision of an exception for certain capital interests is consistent with prior versions of carried interest legislation, which included provisions intending to permit service partners to earn long-term capital gain with respect to their qualified capital interests. However, the rules defining “qualifying” capital and permissible returns in prior versions of the legislation were significantly stricter and arguably more clearly defined. According to the conference report’s explanatory statement, if a partner contributes capital to a partnership, then so long as the partnership agreement provides that the partner’s share of partnership capital is commensurate with

the amount of capital that he or she contributed (as of the time the partnership interest was received) compared to total partnership capital, the partnership interest is not an applicable partnership interest to that extent. On the other hand, the explanatory statement also indicates that it is not intended that a partnership interest would fail to be treated as transferred in connection with the performance of services merely because a partner contributes capital, and the Treasury Department is directed to provide guidance implementing this intent. Reading the two statements together, it is difficult to determine what amount of income associated with contributed capital would be exempt from reclassification under section 1061.

The scope of the provision addressing transfers of applicable partnership interests to related parties is unclear. Presumably, this provision would cause recognition of gain or loss with respect to capital assets held for more than one year but not more than three years (i.e., capital assets with respect to which section 1061 would characterize gain as short-term capital gain) to the extent attributable to the transferred interest, even in nonrecognition transactions. With respect to gain-recognition transactions, the provision may require recognition of short-term capital gain upon a related-party transfer of a partnership interest held for more than three years to the extent of gain attributable to capital assets held by the partnership for more than one year but not more than three years.

The explanatory statement attempts to clarify the statutory language by providing that short-term capital gain treatment will result “notwithstanding section 83 or any election in effect under section 83(b).” According to the explanatory statement, the fact that a taxpayer has included an amount in income under section 83 upon the acquisition of an applicable partnership interest or has made an election under section 83(b) with respect to such an interest does not change the three-year holding period requirement for obtaining long-term capital gain treatment with respect to the applicable partnership interest.



Repeal of partnership technical termination rules

The new law repeals the “technical termination” rules that were contained in Code section 708(b)(1)(B). As a practical matter, although technical terminations sometimes can have favorable results, they also can result in unfavorable tax consequences and additional compliance burdens. Thus, some partnerships may view repealing the technical termination rules as a favorable development.

The JCT has estimated that this provision will raise approximately \$1.6 billion over 10 years.

This provision applies to partnership tax years beginning after December 31, 2017.



Provisions applicable to “eligible terminated S corporations”

The new law contains two generally favorable provisions applicable to “eligible terminated S corporations.” The provisions appear to be based on an expectation that some S corporations may revoke their S corporation status following enactment of the new law. For purposes of both provisions, an eligible terminated S corporation is any C corporation: (i) that was an S corporation on the day before the date of enactment and revokes its S corporation election in the two-year period beginning on the date of such enactment; and (ii) the owners of the stock of which (determined on the date on which such revocation is made) are the same as, and such owners hold the stock in the same proportions as, on the date of enactment.

The first provision relates to accounting method changes required as a result of an S corporation’s conversion to a C corporation. Specifically, the new law provides that, in the case of an eligible terminated S corporation, any section 481 adjustment arising from an accounting method change attributable to the corporation’s revocation of its S corporation election will be taken into account ratably during the six-tax year period beginning with the year of the method change. Thus, a corporation that must change a method of accounting as a result of the revocation of its S corporation election would include any income resulting from that change over six tax years (as opposed to four years).

The second provision revises the treatment of distributions made by certain corporations following their conversion to C corporation status. Under pre-enactment law, distributions by an S corporation generally are treated as coming first from the S corporation’s accumulated adjustments account (AAA), which effectively measures the income of the S corporation that has been taxed to its shareholders but remains undistributed. If AAA is exhausted by the distribution, the excess distribution is treated as coming from any earnings and profits (E&P) of the corporation generated when it was a C corporation (or inherited from a C corporation under section 381). For a shareholder, distributions out of AAA generally are more favorable,

KPMG observation

The repeal of the technical termination provisions has implications that may be viewed favorably or unfavorably by taxpayers, depending on the particular facts and circumstances. For instance, although taxpayers would no longer have to file the two short period tax returns that were required when a partnership technically terminated, more careful consideration may need to be given in M&A transactions as to who will be responsible for filing the partnership tax return when there is a significant change in ownership. Also, partnerships would no longer have the opportunity to adopt a new section 704(c) method as a result of a technical termination, which was previously the case. As a final example, partnerships will no longer need to “re-life” their assets under section 168(i) (7) (and potentially reduce the amount of annual depreciation) as a result of a technical termination, which used to be a significant issue for many partnerships.

Technical termination may still be relevant for state tax purposes for states that do not adopt the federal changes.

KPMG observation

Under pre-enactment law, an S corporation that became a C corporation may have been under pressure from its shareholders to distribute cash equal to its AAA during the PTTP because the AAA effectively represents the income of the corporation with respect to which the pre-C corporation conversion shareholders have already been taxed. Thus, the shareholders may have wanted to avoid the additional layer of tax on that income that arises if the distribution is characterized as a dividend. Allowing a portion of post-PTTP distributions to be treated as coming from AAA as the new law does may allow the corporation to avoid the resulting strain on its liquidity. However, this favorable treatment does not change the general treatment of a distribution from AAA, i.e., that the portion of the distribution attributable to AAA reduces stock basis and results in capital gain to the extent the distribution exceeds basis.

as such distributions are tax-free to the extent of the shareholder's basis in its S corporation stock and then give rise to capital gain. In contrast, distributions out of E&P are treated as dividends and taxed accordingly.

If a corporation's S corporation election terminates, special rules apply to distributions made by the resulting C corporation during the post-transition termination period (PTTP). The PTTP begins on the day after the last day of the corporation's last tax year as an S corporation and generally ends on the later of: (i) the day that is one year after that day; or (ii) the due date for filing the return for such last year as an S corporation (including extensions). However, the PTTP may be extended in certain situations. A distribution of cash made by a C corporation with respect to its stock during the PTTP is applied against and reduces the shareholder's basis in the stock to the extent the amount of the distribution does not exceed the corporation's AAA. Thus, cash distributions by a former S corporation may be subject to the generally beneficial S corporation treatment of distributions, but only during the PTTP. After expiration of the PTTP, any distributions made by the former S corporation would be treated as coming first from the corporation's E&P and thus taxable as a dividend to the extent thereof.

The new law extends in part the generally beneficial treatment of distributions for certain former S corporations beyond the PTTP. Specifically, a distribution of money by an eligible terminated S corporation following the PTTP would be treated as coming out of the corporation's AAA or E&P in the same ratio as the amount of the corporation's AAA bears to the amount of the corporation's accumulated E&P.

The JCT has estimated that the changes applicable to eligible terminated S corporations will decrease revenue by approximately \$6.1 billion over a 10-year period.

The provisions generally are effective as of the date of enactment.



Changes relating to electing small business trusts

For a corporation to qualify as an S corporation, ownership of the corporation's stock is limited to certain permitted shareholders; one type of trust permitted to own stock in an S corporation is an electing small business trust (an ESBT). The portion of an ESBT that owns stock in an S corporation is treated as a separate trust and the S corporation's income allocated to the ESBT is taxed to the trust itself (rather than to the trust's beneficiaries).

To qualify as an ESBT, a trust must meet certain requirements, including that a nonresident alien individual may not be a potential current beneficiary of an ESBT. This is consistent with a rule that precludes a nonresident alien individual from owning stock in an S corporation.

As noted above, an ESBT's allocable share of the corporation's income is taxed to the trust; that income is taxed at the highest individual tax rate. Because an ESBT is a trust, the charitable contribution deduction applicable to trusts—rather than individuals—applies to the ESBT. A trust generally is allowed a deduction for any amount of gross income (without limitation) which is paid for a charitable purpose; no carryover of excess deductions is allowed. In contrast, an individual's charitable contribution deduction is limited to certain percentages of adjusted gross income, with a carryforward of amounts in excess of the limitation.

The new law amends prior law to provide that the charitable contribution deduction allowed for the portion of an ESBT holding S corporation stock is determined under the rules applicable to individuals, rather than those applicable to trusts. The provision applies to tax years beginning after December 31, 2017.

Further, the new law allows a nonresident alien individual to be a potential current beneficiary of an ESBT. The provision is effective on January 1, 2018.

The JCT has estimated that the changes relating to ESBTs will decrease revenue by approximately \$300 million over a 10-year period.

KPMG observation

This provision may expand the number of corporations that elect S corporation status, as well as the ability of S corporation shareholders to engage in gift and estate tax planning. Prior proposals would have made the same change. However, other aspects of the new law may make operating a business as an S corporation less desirable (and thus the expansion of potential current beneficiaries to include nonresident alien individuals may affect only a limited number of corporations).



Banks and financial institutions



Deduction limits for FDIC premiums

The new law amends Code section 162 to limit the amount certain financial institutions may deduct for premiums paid pursuant to an assessment by the Federal Deposit Insurance Corporation (FDIC) to support the deposit insurance fund. The new limitation applies only if the “total consolidated assets” of a financial institution (determined as of the close of the relevant tax year) exceed \$10 billion. A special aggregation rule applies for purposes of calculating “total consolidated assets” within an “expanded affiliated group” of related entities.

Under the new rule, the limitation is equal to the ratio (not to exceed 100%) that (1) “total consolidated assets” in excess of \$10 billion bears to (2) \$40 billion. As a result, for financial institutions with “total consolidated assets” in excess of \$50 billion, no deduction for such premiums may be claimed.

The provision is effective for tax years beginning after December 31, 2017. The JCT has estimated the limitation on deduction for FDIC premiums will increase revenues by approximately \$14.8 billion over 10 years.



Bonds



Repeal of tax credit bonds

Section 13404 of the new law repeals the rules related to tax credit bonds. The repealed provisions relate to:

- Clean renewable energy bonds
- New clean renewable energy bonds
- Qualified zone academy bonds
- Qualified forestry conservation bonds
- Qualified energy conservation bonds
- Qualified school construction bonds
- Build America Bonds

The new law also repeals Code section 6431, which provides an election that allows an issuer of tax credit bonds to receive a payment in lieu of the holder receiving a credit. This provision also repeals Code section 1397E, which permits an eligible taxpayer that holds a qualified zone academy bond to claim a credit against taxable income.

The provision is effective for bonds issued after December 31, 2017, but the repeal does not affect the tax treatment of existing obligations. The JCT has estimated this provision will reduce revenues by approximately \$0.5 billion over 10 years.

KPMG observation

The federal government no longer provides new allocations for many of the bonds that are repealed through this provision. Therefore, it may have minimal impact on the current municipal bond market. However, the provision may end recent discussions requesting the federal government to reintroduce certain bonds (such as Build America Bonds, which expired on January 1, 2011). The provision may also have a significant negative effect on participants that still receive the benefit from newly issued tax credit bonds, including public schools financed through qualified zone academy bonds and power providers that issue new clean renewable energy bonds.

Under pre-enactment law, the advance refunding rules permitted an issuer to refinance a prior bond issue to achieve debt service savings even though that issue may not be callable for more than 90 days from the issuance of the refunding bonds. The new provision may increase the cost of debt for organizations eligible to advance refund prior bond issues, such as section 501(c)(3) organizations.

Advance refunding bonds issued on or before December 31, 2017, are not affected by these changes. Notably, the provision does not appear to include a transition rule that would permit the advance refunding of bonds issued before January 1, 2018. In addition, interest on refunding bonds issued within 90 days of the redemption of the refunded bond (i.e., not advance refunding bonds) remains tax-exempt.



Repeal of advance refunding bonds

The new law subjects to tax the interest on advance refunding bonds—bonds used to pay principal, interest, or redemption price on a prior bond issue. Advance refunding bonds are those refunding bonds that are issued more than 90 days before the redemption of the refunded bonds. In general, governmental bonds and qualified 501(c)(3) bonds may be advance refunded only one time, while private activity bonds (other than qualified 501(c)(3) bonds) may not be advance refunded at all. The provision applies to bonds issued after December 31, 2017.

The JCT has estimated the repeal of advance refunding bonds will increase revenues by approximately \$17.4 billion over 10 years.





Insurance

The new law makes several changes that could affect the taxation of the insurance industry.



Net operations loss deductions of life insurance companies

The net operation loss provision (section 13511 of the new law) alters the operations loss carryover and carryback periods for life insurance companies (carried back three years and forward 15) by striking Code sections 810 and 844 and conforming these periods to those of other corporations.

The new law also modifies the carryover and carryback rules for all corporations. Generally, net operating loss carrybacks are repealed and taxpayers are allowed to carry net operating losses forward indefinitely (except for a special two-year carryback in the case of certain losses incurred in the trade or business of farming). Under the provision, taxpayers' ability to deduct a net operating loss carryover (or carryback, under the aforementioned casualty loss provision) is limited to 80% of the taxpayer's taxable income for the year for tax years beginning after December 31, 2017.

The revenue effect is included in the JCT estimate for the broader modification of the net operating loss above.

KPMG observation

This provision puts life insurance companies on the same loss carryback and carryforward schedule as other corporations.

The repeal of nearly all carrybacks could have a substantial impact on a life company's deferred tax asset admissibility computation for statutory accounting purposes.

The first part of the admissibility test under SSAP 101 would no longer be applicable for ordinary deferred tax assets since it allows insurance companies to use a reversal period that corresponds to the tax loss carryback provisions of the Code.

KPMG observation

This provision puts life insurance companies and non-life insurance companies on different loss carryback and carryforward schedules. Unlike the impact on the life insurance industry, a non-life insurance company's deferred tax asset admissibility computation for statutory accounting purposes does not change. The first part of the admissibility test under SSAP 101 is still applicable and allows the same computations as under pre-enactment law. The 80% limitation applicable to life insurance companies and other corporations is not applicable to non-life insurance companies. The mismatch of the treatment of NOLs between life and non-life companies could potentially lead to consolidation difficulties and the need to keep detailed schedules for tracking purposes.

KPMG observation

This provision is described as eliminating special treatment for a segment of the insurance industry in which "the risk distribution benefits of risk pooling are the weakest." The provision does not eliminate a similar benefit for small property and casualty insurers.



Net operations loss deductions of property and casualty insurance companies

The new law (section 13302) preserves pre-enactment law for net operating losses of property and casualty companies. Thus, net operating losses of property and casualty companies may be carried back 2 years and carried forward 20 years.



Repeal small life insurance company deduction

Code section 806 allows life insurance companies to currently deduct 60% of their first \$3 million of life insurance-related income. Under pre-enactment law, the deduction was phased out for companies with income between \$3 million and \$15 million. In addition, the deduction was not available to life insurance companies with assets of at least \$500 million.

Section 13512 of the new law repeals the Code section 806 special deduction for small life insurance companies.

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will increase revenues by approximately \$0.2 billion over 10 years.



Repeal Code section 807(f) spread— Adjustment for change in computing reserves

Under 807(f), certain taxpayers are required to make adjustments to taxable income when they change a tax accounting method, so that the accounting method change does not result in an omission or duplication of income or expense. For taxpayers other than life insurance companies, an adjustment that reduces taxable income generally is taken into account in the tax year during which the accounting method change occurs, while an adjustment that increases taxable income may be taken into account over the course of four tax years, beginning with the tax year during which the accounting method change occurs.

Section 13513 of the new law repeals a special 10-year period for adjustments to take into account changes in a life insurance company's basis for computing reserves. The general rule for tax accounting method adjustments applies to changes in computing reserves by life insurance companies, generally ratably over a four-year period, instead of over a 10-year period.

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will increase revenues by approximately \$1.2 billion over 10 years.



Repeal special rule for distributions to shareholders from pre-1984 policyholders surplus accounts

Previous rules enacted in 1959 included a rule that half of a life insurer's operating income was taxed only when the company distributed it, and a "policyholders surplus account" kept track of the untaxed income. In 1984, this deferral of taxable income was repealed, although existing policyholders' surplus account balances remained untaxed until they were distributed. Legislation enacted in 2004 provided a two-year holiday that permitted tax-free distributions of these balances during 2005 and 2006. During this period, most companies eliminated or significantly reduced their balances.

Section 13514 of the new law repeals the rules for distributions from pre-1984 policyholders' surplus accounts.

The provision is generally effective for tax years beginning after 2017, and any remaining balances are subject to tax payable ratably over the first eight tax years beginning after December 31, 2017.

The JCT has estimated that the provision will increase revenues by less than \$50 million over 10 years.

KPMG observation

This provision puts life reserve computation changes on the one-year or four-year spread rules applicable to general changes in methods of accounting. The provision appears to provide that changes in life insurance reserve basis continue to be an automatic adjustment and not require prior approval for such changes.

KPMG observation

This provision was suggested by the American Bar Association Tax Section Insurance Companies Committee and is not expected to raise significant revenue.

KPMG observation

The conference report indicates that the increase in the haircut within the provision will keep the reduction in the reserve deduction consistent with pre-enactment law by adjusting the rate proportionally to the decrease in the corporate tax rate. That rationale may not be consistent with the provision's purpose under pre-enactment law, which is to measure the amount of tax-exempt income credited to reserves (estimated at 15%) in order to eliminate a double benefit. Although the reduction is significant, a rate tied to the product of the proration percentage and top corporate tax rate may still be preferable overall to many insurers since the calculated rate facilitates predictability of after-tax rates of return on tax-exempt bonds and compares those rates to other investments.

KPMG observation

Code section 847 was originally enacted to provide for the admissibility of deferred tax assets associated with loss reserve discounting under the recognition rules of FAS 96.

FAS 109 liberalized these requirements, and, as a result, section 847 is largely unnecessary and administratively burdensome.



Modify proration rules for property and casualty insurance companies

A proration rule applies to P&C companies. In calculating the deductible amount of its reserve for losses incurred under pre-enactment law, a P&C company was required to reduce the amount of losses incurred by 15% of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received, and (3) the increase for the tax year in the cash value of life insurance, endowment, or annuity contracts the company owns. The proration rule reflects the fact that reserves are generally funded in part from tax-exempt interest, from deductible dividends, and from other untaxed amounts.

Section 13515 of the new law replaces the 15% reduction under pre-enactment law with a reduction equal to 5.25% divided by the top corporate tax rate. The proration percentage is automatically adjusted in the future if the top corporate tax rate is changed, so that the product of the proration percentage and the top corporate tax rate always equals 5.25%. The top corporate rate is 21% for 2018 and thereafter, so the percentage reduction is 25% under the proration rules for P&C companies.

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will increase revenues by approximately \$2.1 billion over 10 years.



Repeal elective deduction and related special estimated tax payment rules

Under pre-enactment law, insurance companies could elect to claim a deduction equal to the difference between the amount of reserves computed on a discounted basis and the amount computed on an undiscounted basis. Companies that made this election were required to make a special estimated tax payment equal to the tax benefit attributable to the deduction.

Section 13516 of the new law repeals the Code section 847 elective deduction and related special estimated tax payment rules. The entire balance of an existing account is included in income of the taxpayer for the first tax year beginning after 2017, and the entire amount of existing special estimated tax payments are applied against the amount of additional tax attributable to the inclusion. Any special estimated tax payments in excess of this amount are treated as estimated tax payments under section 6655.

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will increase revenues by less than \$50 million over 10 years.



Computation of life insurance tax reserves

Under pre-enactment law, Code section 807(d)(1) provided that the deduction allowed for life insurance reserves for a contract is the greater of the net surrender value or the Federally Prescribed Reserve. Code section 807(d) provided that the interest rate used in computing the Federally Prescribed Reserve for a contract is the greater of the prevailing state interest rate or the 60-month rolling average of the applicable federal midterm rate. The prevailing state assumed interest rate is equal to the highest assumed interest rate permitted to be used in at least 26 States in computing regulatory life insurance reserves. The discount rate used by property and casualty (P&C) insurance companies for reserves is the applicable Federal midterm rate over the 60 months ending before the beginning of the calendar year for which the determination is made.

Section 13517 of the new law allows life insurance companies to take into account the amount of the life insurance reserves for any contract, which is calculated as the greater of (1) the net surrender value of the contract or (2) 92.81% of the reserve computed as required by the National Association of Insurance Commissioners (NAIC) at the time the reserve is determined.

The new law maintains the requirements that tax reserves cannot be less than the contract's cash surrender value or greater than the statutory reserve for the contract. The new law eliminates the requirement that the reserve method used for tax purposes be the method prescribed by the NAIC in effect on the date of the issuance of the contract. A no-double-counting rule provides that no amount or item is taken into account more than once in determining a reserve under subchapter L. The conference report's explanatory statement provides several examples of the application of the no-double-counting provision. The new law adds a reporting requirement with respect to the opening and closing balance of reserves and with respect to the method of computing reserves for purposes of determining income.

The provision is generally effective for tax years beginning after 2017. The effect of the provision on computing reserves for contracts issued before the effective date is to be taken into account ratably over the succeeding eight tax years.

The JCT has estimated that the provision will raise \$15.2 billion over 10 years.

KPMG observation

The provision in the new law uses a 7.19% haircut of statutory reserves. The elimination of the pre-enactment law requirement that the reserve method be set at the time the contract is issued may also eliminate any question about whether changes made by the NAIC to reserve methods should be reflected in the tax reserve.

KPMG observation

The pre-enactment rules were complex and based on an archaic system of life insurance company taxation. This provision simplifies the proration calculation by setting the company share and policyholder share percentages to a fixed amount.

KPMG observation

When section 848 was originally enacted, there was significant debate over the appropriate capitalization percentage and amortization period. Note also that unamortized deferred acquisition cost (DAC) amounts that existed before the law change was effective are not affected and the associated amortization continues over the previous 10-year period.



Modify rules for life insurance proration for purposes of determining the dividends received deduction

Under pre-enactment law, deductions were limited or disallowed in certain circumstances if they were related to the receipt of exempt income. Under the “pro-ration” rules, life insurance companies are required to reduce deductions, including dividend received deductions (DRDs) and reserve deductions, to account for the fact that a portion of dividends and tax-exempt interest received is used to fund tax-deductible reserves for the companies’ obligations to policyholders. This portion is determined by a formula that computes the respective shares of net investment income that belong to the company and to the policyholders.

Section 13518 of the new law changes the life insurance company proration rules for the DRD in Code section 805(a)(4) by changing the company share to 70% and the policyholder share to 30%.

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will raise approximately \$0.6 billion over 10 years.



Capitalize certain policy acquisition expenses (DAC)

Section 13519 of the new law increases the capitalization rates applicable to specified insurance contracts under Code section 848. The pre-enactment proxy rates applied to net premiums on “specified insurance contracts” were as follows:

- Annuity contracts (1.75%)
- Group life contracts (2.05%)
- All other specified contracts (7.7%)

The provision allowed for a 10-year spread.

The provision in the new law is as follows:

- Annuity contracts (2.09%)
- Group life contracts (2.45%)
- All other specified contracts (9.2%)

The provision extends the amortization period from a 120-month period to a 180-month period. The new law does not change the special rule providing for the 60-month amortization of the first \$5 million (with phase-out).

The provision is effective for tax years beginning after 2017.

The JCT has estimated that the provision will increase revenues by approximately \$7.2 billion over 10 years.



Tax reporting for life settlement transactions, clarification of tax basis of life insurance contracts, and exception to transfer for valuable consideration rules

Under Code section 101(a)(1), there is an exclusion from federal income tax for amounts received under a life insurance contract paid by reason of the death of the insured. Under section 101(a)(2), under the transfer for value rules, if a life insurance contract is sold or otherwise transferred for valuable consideration, the amount paid by reason of the death of the insured that is excludable is generally limited.

Further, in Revenue Ruling 2009-13, the IRS ruled that income recognized under section 72(e) on surrender to the life insurance company of a life insurance contract with cash value is ordinary income. In the case of a sale of a cash value life insurance contract, the IRS ruled that the insured's (seller's) basis is reduced by the cost of insurance, and the gain on sale of the contract is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered (the "inside buildup") and excess is long-term capital gain.

In Revenue Ruling 2009-14, the IRS ruled that under the transfer for value rules, a portion of the death benefit received by a buyer of a life insurance contract on the death of the insured is includible as ordinary income. The portion is the excess of the death benefit over the consideration and other amounts (e.g., premiums) paid for the contract. Upon sale of the contract by the purchaser of the contract, the gain is long-term capital gain and in determining the gain, the basis of the contract is not reduced by the cost of insurance.

The new law imposes reporting requirements in the case of the purchase of an existing life insurance contract in a reportable policy sale and imposes reporting requirements on the insurance company issuing the life insurance or annuity contract. Lastly, the provision modifies the transfer for value rules in a transfer of an interest in a life insurance contract in a reportable policy sale.

The JCT has estimated that these provisions will increase revenues by approximately \$0.2 billion over 10 years.

Reporting requirements for acquisitions of life insurance contracts

The reporting requirement in section 13520 of the new law applies to every person who acquires a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale during the tax year. A reportable policy sale means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured (apart from the acquirer's interest in the life insurance contract). An indirect acquisition includes the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract. Under the reporting requirement, the buyer reports information about the purchase to the IRS, to the insurance company that issued the contract, and to the seller. The information reported by the buyer about the purchase is (1) the buyer's name, address, and taxpayer identification number (TIN), (2) the name, address, and TIN of each recipient of payment in the reportable policy sale, (3) the date of the sale, and (4) the amount of each payment. The statement the buyer provides to any issuer of a life insurance contract is not required to include the amount of the payment or payments for the purchase of the contract.

The provision adds to the insurer's reporting responsibilities by requiring it to identify and report seller information to the IRS. In addition, the reversal of the IRS's position in Rev. Rul. 2009-13 simplifies the insurer's reporting responsibilities by eliminating the bifurcated basis and investment in the contract calculations for contracts surrendered at a gain vs. contracts surrendered at a loss. Whether or not to reduce a seller's basis by the cost of insurance has been a controversial issue, and the provision provides clarity to this situation.

Reporting of seller's basis in the life insurance contract

On receipt of a report described above, or on any notice of the transfer of a life insurance contract to a foreign person, the issuer is required to report to the IRS and to the seller (1) the basis of the contract (i.e., the investment in the contract within the meaning of section 72(e)(6)), (2) the name, address, and TIN of the seller or the transferor to a foreign person, and (3) the policy number of the contract. Notice of the transfer of a life insurance contract to a foreign person is intended to include any sort of notice, including information provided for nontax purposes such as change of address notices for purposes of sending statements or for other purposes, or information relating to loans, premiums, or death benefits with respect to the contract.

Reporting with respect to reportable death benefits

When a reportable death benefit is paid under a life insurance contract, the payor insurance company is required to report information about the payment to the IRS and to the payee. Under this reporting requirement, the payor reports (1) the gross amount of the payment; (2) the taxpayer identification number of the payee; and (3) the payor's estimate of the buyer's basis in the contract. A reportable death benefit means an amount paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale. For purposes of these reporting requirements, a payment means the amount of cash and the fair market value of any consideration transferred in a reportable policy sale.

Determination of basis

Section 13521 of the new law provides that in determining the basis of a life insurance or annuity contract, no adjustment is made for mortality, expense, or other reasonable charges incurred under the contract (known as "cost of insurance"). This reverses the position of the IRS in Revenue Ruling 2009-13 that on sale of a cash value life insurance contract, the insured's (seller's) basis is reduced by the cost of insurance.

Scope of transfer for value rules

Section 13522 of the new law provides that the exceptions to the transfer for value rules do not apply in the case of a transfer of a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale. Thus, some portion of the death benefit ultimately payable under such a contract may be includible in income.

Under the provision, the reporting requirement is effective for reportable policy sales occurring after December 31, 2017, and reportable death benefits paid after December 31, 2017. The clarification of the basis rules for life insurance and annuity contracts is effective for transactions entered into after August 25, 2009. The modification of exception to the transfer for value rules is effective for transfers occurring after December 31, 2017.



Modify discounting rules for property and casualty insurance companies

Under pre-enactment law, pursuant to Code section 846, a P&C company could deduct unpaid losses that are discounted using midterm applicable federal rates and based on a loss payment pattern. The loss payment pattern for each line of insurance business is determined by reference to the industry-wide historical loss payment pattern applicable to such line of business, although companies may elect to use their own particular historical loss payment patterns. In the case of long-tail lines of business, a special rule extends the loss payment pattern period, so that the amount of losses which would have been treated as paid in the tenth year after the accident year is treated as paid in the tenth year and in each subsequent year (up to five years) in an amount equal to the amount of the losses treated as paid in the ninth year after the accident year.

Section 13523 of the new law requires P&C insurance companies to use a higher rate—the corporate bond yield curve (as specified by Treasury)—to discount their unpaid losses under Code section 846. The corporate bond yield curve is defined by section 430(h)(2)(D)(i), but a 60-month period is substituted for a 24-month period. The corporate bond yield curve means, with respect to any month, a yield curve that reflects the average, for the preceding 60-month period of monthly yields on investment grade corporate bonds with varying maturities and that in the top three quality levels available.

The provision also repeals the election in section 846(e) to use company-specific, rather than industry-wide, historical loss payment patterns.

The three-year period for discounting certain lines of business other than long-tail lines of business is not modified under the new law.

The special rule that extends the loss payment pattern period for long-tail lines of business remains (but with the five-year limitation on the extended period increased to 14 years) so that:

- The amount of losses which would have been treated as paid in the tenth year after the accident year shall be treated as paid in such tenth year and each subsequent year in an amount equal to the amount of the average of the losses treated as paid in the seventh, eighth, and ninth years after the accident year (or, if lesser, the portion of the unpaid losses not therefore taken into account)
- To the extent such unpaid losses have not been treated as paid before the 24th year after the accident year, they shall be treated as paid in the 24th year

The provision generally is effective for tax years beginning after 2017, with a transition rule that spreads adjustments relating to pre-effective date losses and expenses over such tax year and the succeeding seven tax years.

The JCT has estimated that the provision will raise approximately \$13.2 billion over 10 years.

KPMG observation

The change in loss payment patterns may provide simplification, but would shorten or lengthen the pattern for different lines of business, which may or may not correspond more closely with actual loss payment patterns in the industry.

Elimination of the section 846(e) election may provide simplification, but may affect some insurers more significantly than others.



Exempt organizations

The new law includes a number of changes that affect tax-exempt organizations.

Unless otherwise stated, the provisions described below are effective for tax years beginning after December 31, 2017.



Unrelated business taxable income separately computed for each trade or business activity

Under the new law, a tax-exempt organization is required to calculate separately the net UBTI of each unrelated trade or business. Any loss derived from one unrelated trade or business may not be used to offset income from another unrelated trade or business, and NOL deductions are allowed only with respect to the trade or business from which the loss arose.

This change does not apply to any NOLs arising in a tax year beginning before January 1, 2018, and such NOLs may be applied to reduce aggregate UBTI arising from all unrelated businesses.

The JCT has estimated the provision will increase revenues by approximately \$3.5 billion over 10 years.

KPMG observation

The new law includes all of the exempt organization provisions that were in the Senate bill but omits most of the proposals from the House bill, including:

- Termination of private activity bonds
- Clarification of unrelated business income tax treatment of public pension plans and other entities treated as exempt from taxation under section 501(a)
- Exclusion of research income limited to publicly available research
- Simplification of excise tax on private foundation investment income
- Private operating foundation requirements relating to operation of art museum
- Exception from private foundation excess business holding tax for independently operated philanthropic business holdings
- 501(c)(3) organizations permitted to make statements relating to political campaign in ordinary course of activities
- Additional reporting requirements for donor advised fund sponsoring organizations

KPMG observation

The new law follows the Senate bill.

Under pre-enactment law, tax-exempt organizations calculated UBTI based on all unrelated business activities regularly carried on, less the deductions directly connected with carrying on those activities. In other words, losses generated by one activity generally could offset income earned from another activity. The new law prevents organizations from calculating UBTI on an aggregate basis.

Under the new law, it is unclear how to determine whether an activity constitutes a single or multiple trades or businesses.

KPMG observation

The provision does not apply to public colleges or universities even if similarly situated in asset size to their private counterparts.

In determining whether the excise tax applies to a particular college or university, it is necessary to determine whether and to what extent to include the assets and net investment income of related organizations. For example, the new law provides that such amounts shall be taken into account with respect to no more than one educational institution. In addition, unless the related organization is controlled by or a supporting organization of the college or university, only assets and net investment income that are intended or available for the use or benefit of the educational institution shall be taken into account.

The conference report's explanatory statement indicates that Congress intends for Treasury and the IRS to promulgate regulations describing:

- Assets that are used directly in carrying out the educational institution's exempt purpose;
- Computation of net investment income; and
- Assets that are intended or available for the use or benefit of the educational institution.

This provision was modified on December 20, 2017, to remove a "tuition-paying" requirement in determining whether an institution meets the 500-student threshold. See Executive Summary for more information.



Excise tax based on investment income of private colleges and universities

The new law imposes a 1.4% excise tax on the net investment income of private colleges and universities with at least 500 students (more than 50% of which are located in the United States) and non-exempt use assets with a value at the close of the preceding tax year of at least \$500,000 per full-time student. A university's assets generally will include assets held by certain related organizations (including supporting organizations to the university and organizations controlled by the university), and a university's net income generally includes investment income derived from those assets.

The JCT has estimated the provision will increase revenues by approximately \$1.8 billion over 10 years.



Repeal of deduction for amounts paid in exchange for college athletic event seating rights

The new law eliminates the charitable contribution deduction for payments made for the benefit of a higher education institution that grant the donor the right to purchase seating at an athletic event in the athletic stadium of such institution. Pre-enactment law (section 170(l)) generally permitted a deduction of 80% of the value of the payment.

The JCT has estimated the provision will increase revenues by approximately \$2 billion over 10 years.



Repeal of substantiation exception in case of contributions reported by donee

The new law repeals an inactive provision that exempted donors from substantiating charitable contributions of \$250 or more through a contemporaneous written acknowledgment, provided that the donee organization filed a return with the required information. This provision applies to contributions made in tax years beginning after December 31, 2016.

The JCT has estimated the provision would have negligible revenue effects.





International

In the context of international tax, the new law substantially eliminates any element of deferred taxation of foreign income within a U.S.-parented multinational group—generally income is taxed as earned, or is permanently exempt from U.S. taxation. Despite allowing permanent exemption for a residual class of income, the new law generally retains subpart F to provide full and immediate taxation of the classes of income that are captured by pre-enactment law, and furthermore subjects a new, very broad, class of income (“global intangible low-taxed income”) to immediate taxation at a reduced rate. The new law does, however, also grant the benefit of a reduced rate to a new class of income earned directly by a U.S. corporation (“foreign-derived intangible income”). In all of these respects, the new law generally follows the approach set forth in the Senate bill. As a transition from the former deferral regime to these new rules, existing untaxed earnings of “specified foreign corporations” are deemed repatriated and taxed at a reduced rate that depends upon the extent to which the earnings are matched by cash held offshore.

The new law also contains provisions intended to curtail base erosion. Interest expense is limited to 30% of adjusted taxable income (a measure which initially tracks to EBITDA but transitions to a more stringent standard of EBIT),⁹ and deductions are disallowed for transactions involving related parties and hybrid instruments or transactions. The new law also adopts (with modifications) a novel new alternative minimum tax focused on deductible payments made by U.S. persons to related foreign persons originally proposed in the Senate bill.

Certainly, the sum total of these changes represents a significant expansion of the base of cross-border income to which current U.S. taxation applies.

⁹ The new law does not include additional limitations on interest expense based on a worldwide group’s relative levels of indebtedness within and without the United States, even though the House and Senate bills each contained a proposal (somewhat different from each other) along such lines.

The 100% participation exemption system moves the United States away from a worldwide tax system and closer to a territorial tax system for earnings of foreign corporations, but only to the extent those earnings are neither subpart F income, nor subject to the minimum tax rule discussed below. The participation exemption provision largely follows the participation exemption proposal in the House bill, which was modeled after a 2014 tax reform discussion draft introduced by the then-chairman of the Ways and Means Committee. For corporations earning only foreign source income, the mechanics of the new participation exemption are largely irrelevant.

The explanatory statement indicates that the term “dividend received” should be interpreted broadly. As an example, the explanatory statement describes a domestic corporation that indirectly owns stock of a foreign corporation through a foreign partnership. According to the example, the domestic corporation will be allowed a participation DRD with respect to its distributive share of the partnership’s dividend from the foreign corporation if the domestic corporation would qualify for the 100% DRD with respect to dividends from the foreign corporation if the domestic corporation had owned the stock directly.



Establishment of participation exemption system for taxation of foreign income

Add U.S. participation exemption

The new law adds a new Code section 245A that allows a domestic corporation that is a U.S. shareholder (as defined in section 951(b)) of a specified 10% foreign corporation a 100% dividends received deduction (DRD) for the foreign-source portion of dividends received from the foreign corporation (a 100% DRD). The 100% DRD is available only to domestic C corporations that are neither real estate investment trusts nor regulated investment companies.

For the purposes of new section 245A, the term “specified 10% foreign corporation” is defined as any foreign corporation with respect to which any domestic corporation owns at least 10%. Passive foreign investment companies (PFICs), however, are specifically excluded from the definition; thus dividends from PFICs do not qualify for the 100% DRD.

The foreign-source portion of a dividend equals the same proportion of the dividend as the foreign corporation’s undistributed foreign earnings bears to its total undistributed earnings. A foreign corporation’s undistributed foreign earnings consists of all undistributed earnings except for income effectively connected with the conduct of a trade or business in the United States and dividend income received from an 80%-owned domestic corporation. Total undistributed earnings include all earnings without reduction for any dividends distributed during the tax year.

The new law provides that a DRD is not available for any hybrid dividend, which is generally defined as an amount received from a controlled foreign corporation (CFC) for which the foreign corporation received a deduction or other tax benefit related to taxes imposed by a foreign country. Additionally, to the extent a domestic corporation is a U.S. shareholder with respect to tiered CFCs, a hybrid dividend paid from a lower-tier CFC to an upper-tier CFC is treated as subpart F income to the upper-tier CFC, and the U.S. shareholder is required to include in gross income an amount equal to the shareholder’s pro rata share of subpart F income.

A corporate U.S. shareholder may not claim a foreign tax credit (FTC) or deduction for foreign taxes paid or accrued with respect to any dividend allowed a 100% DRD. Additionally, for purposes of calculating a corporate U.S. shareholder’s Code section 904(a) FTC limitation, the shareholder’s foreign source income does not include (i) the entire foreign source portion of the dividend, and (ii) any deductions allocable to a 100% DRD (or stock that gives rise to a 100% DRD).

In addition to owning 10% of the voting power of the foreign corporation, a domestic corporation needs to satisfy a holding period requirement. Specifically, a domestic corporation is not permitted a 100% DRD with respect to a dividend paid on any share of stock that is held for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the dividend is paid. Additionally, the foreign corporation must qualify as a specified 10% foreign corporation and the domestic corporation must likewise qualify as a 10% shareholder at all times during the period.

The 100% DRD provision applies to distributions made after December 31, 2017 and is expected to reduce revenues by approximately \$223.6 billion over 10 years.

Add special rules relating to sales or transfers involving specified 10% owned foreign corporations

The new law allows certain deemed dividends under Code section 1248 to qualify for a 100% DRD. Specifically, if a domestic corporation has gain from the sale or exchange of stock of a foreign corporation that it has held for at least one year, any amount that is treated as a dividend under Code section 1248 is eligible for the 100% DRD. The provision also includes special subpart F inclusion rules that allow a U.S. shareholder a 100% DRD with respect to gain on the sale of foreign stock by a CFC that is treated under section 964(e) as a dividend to the selling CFC.

The new law provides two loss limitation rules. First, it provides that if a U.S. shareholder that is a domestic corporation has received a dividend from a foreign corporation that is allowed a 100% DRD, solely for the purposes of determining the domestic corporation's loss on the sale of stock of the foreign corporation, the domestic corporation reduces its basis in the stock of the foreign corporation by an amount equal to the 100% DRD.

Second, the new law requires domestic corporations to recapture foreign branch losses in certain foreign branch transfer transactions. If a domestic corporation transfers substantially all the assets of a foreign branch (within the meaning of Code section 367(a)(3)(C)) to a 10%-owned foreign corporation of which it is a United States shareholder after the transfer, the domestic corporation must include in gross income the "transferred loss amount" (TLA) with respect to such transfer.

The TLA is defined as the excess (if any) of:

- The sum of losses incurred by the foreign branch and allowed as a deduction to the domestic corporation after December 31, 2017, and before the transfer, over
- The sum of (1) any taxable income of such branch for a tax year after the tax year in which the loss was incurred, through the tax year of the transfer, and (2) any amount recognized under the section 904(f)(3) "overall foreign loss recapture" (OFLR) provisions on account of the transfer.

The amount of the domestic corporation's income inclusion under this provision would be reduced by all gains recognized on the transfer, except gains attributable to "branch loss recapture" under section 367(a)(3)(C).

Lastly, the new law repeals the active trade or business exception of section 367(a)(3) for transfers made after December 31, 2017.

The provision requiring basis adjustments to a foreign corporation's stock applies to distributions made after December 31, 2017.

The provisions relating to section 91 inclusions are effective for transfers made after December 31, 2017.

The combined provisions are expected to increase revenues by approximately \$11.8 billion over 10 years.

KPMG observation

The new law is similar to provisions in the House and Senate bills, with two important exceptions. First, the new law follows the Senate bill in repealing the section 367(a)(3) active trade or business exception; the House bill contained no such provision. The repeal of the section 367(a)(3) active trade or business exception is consistent with the Senate bill's theme of disfavoring the use of foreign branches.

Second, the 2014 reform proposal and the Senate bill would have limited section 91 inclusions to the section 245A DRD amount, with the excess amount carried forward subject to the same section 245A limitation. The new law does not include this limitation.

Unfortunately, like the House and Senate proposals, the new law fails to provide clear rules for coordinating section 91 inclusions with dual consolidated loss recapture, thus creating uncertainty with respect to these potentially overlapping regimes.

KPMG observation

The new law includes two measuring dates for determining an SFC's deferred income. The new law's November 2 measuring date adds complexity to the transition rule because it requires each SFC to calculate its deferred income on a date that is not likely to coincide with regular reporting cycles. Additionally, the inclusion of the December 31 measuring date requires SFCs to compute their deferred income twice because the E&P taken into account under the transition rule is the greater amount.

KPMG observation

A "U.S. shareholder" includes domestic corporations, partnerships, trusts, estates, and U.S. individuals that directly, indirectly, or constructively own 10% or more of an SFC's voting power. As a result, noncorporate U.S. shareholders are exposed to inclusions under the new law's transition rule if the SFC is a controlled foreign corporation or any foreign corporation with at least one domestic corporate U.S. shareholder, even though the participation exemption regime for dividends from foreign subsidiaries in the new law only applies to corporate U.S. shareholders.

The new law's repeal of section 958(b)(4) applies for purposes of determining whether a foreign corporation is an SFC and also for purposes of determining whether a U.S. person is a U.S. shareholder. For example, if a domestic corporation owns 9% of a foreign affiliate, and the remaining 91% of the foreign affiliate is owned by the domestic corporation's foreign parent, the foreign affiliate is an SFC and the domestic corporation is a U.S. shareholder of the affiliate. Therefore, the domestic corporation would have to include its pro rata share of the foreign affiliate's deferred income, although the amount of the domestic corporation's mandatory inclusion would be based solely on its direct and indirect ownership (here, 9%) of the foreign affiliate and only take into account E&P accrued during periods the foreign affiliate was an SFC. Also, foreign income taxes paid or accrued by the foreign affiliate are not attributed to the domestic corporation's mandatory inclusion because the domestic corporation does not own at least 10% of the foreign affiliate's voting stock. These consequences could affect the domestic corporation's estimated tax liability.

Mandatory repatriation

The new law includes a transition rule to effect the participation exemption regime. This transition rule provides that the subpart F income of a specified foreign corporation (SFC) for its last tax year beginning before January 1, 2018, is increased by the greater of its accumulated post-1986 deferred foreign income (deferred income) determined as of November 2 or December 31, 2017 (a measuring date). A taxpayer generally includes in its gross income its pro rata share of the deferred income of each SFC with respect to which the taxpayer is a U.S. shareholder, which will be computed on a consolidated basis pursuant to Notice 2018-07. This mandatory inclusion, however, is reduced (but not below zero) by an allocable portion of the taxpayer's share of the foreign E&P deficit of each SFC with respect to which it is a U.S. shareholder and the taxpayer's share of its affiliated group's aggregate unused E&P deficit.

The transition rule includes a participation exemption, the net effect of which is to tax a U.S. shareholder's mandatory inclusion at a 15.5% rate to the extent it is attributable to the shareholder's aggregate foreign cash position and at an 8% rate otherwise.

SFC and U.S. shareholder definitions

An SFC is a foreign corporation that is a controlled foreign corporation (CFC) or foreign corporation that has at least one domestic corporate U.S. shareholder. The new law revises the definition of "U.S. shareholder" in section 951(b) to include any U.S. person that owns at least 10% of the vote or value of a foreign corporation. However, this change is made effective for tax years of foreign corporations beginning after December 31, 2017, and thus, does not apply for purposes of the new law's transition rule.

The new law removes section 958(b)(4) for the last tax year of foreign corporations beginning before January 1, 2018 and all subsequent tax years and for the tax years of a U.S. shareholder with or within which such tax years end. Thus, "downward attribution" of stock ownership from foreign persons is taken into account for purposes of determining whether a U.S. person is a U.S. shareholder of a foreign corporation for purposes of the new law's transition rule.

Deferred income and E&P deficits

Deferred income is an SFC's E&P accumulated in tax years beginning after December 31, 1986, for the periods in which the corporation was an SFC, determined as of the measuring date (i.e., November 2 or December 31, 2017) and that are not attributable to effectively connected income that is subject to U.S. tax or amounts that if distributed would be excluded from a U.S. shareholder's gross income under the section 959 previously taxed income (PTI) rules (either previously or in the tax year to which the transition rule applies) (post-1986 E&P). For these purposes, an SFC's post-1986 E&P are not reduced for dividends during the mandatory repatriation year, other than dividends distributed to another SFC.

A U.S. shareholder can reduce, but not below zero, its pro rata share of an SFC's post-1986 E&P by an allocable portion of the shareholder's pro rata share of its SFCs' post-1986 E&P deficits (aggregate E&P deficit); the new law clarifies that hovering deficits are included for these purposes. A U.S. shareholder allocates its aggregate E&P deficit to its SFCs with positive post-1986 E&P in proportion to the amount of their post-1986 E&P. The post-1986 E&P of an SFC that is reduced by an allocable portion of a U.S. shareholder's aggregate E&P deficit is treated as PTI beginning with the SFC's last tax year that begins before January 1, 2018. Additionally, if an SFC's post-1986 E&P deficit is used to offset another SFC's post-1986 E&P, the E&P of the SFC with the post-1986 E&P deficit is increased, for tax years beginning with the SFC's last tax year that begins before January 1, 2018, by the amount of the offset.

After allocating its aggregate E&P deficit, a U.S. shareholder that would otherwise have deferred income (i.e., the aggregate of the U.S. shareholder's pro rata share of its SFCs' post-1986 E&P exceeds its aggregate E&P deficit) can reduce its deferred income by its share of its affiliated group's aggregate unused E&P deficit. An affiliated group's "aggregate unused E&P deficit" is the sum of each group member's "unused E&P deficit," which generally is the amount by which a group member's aggregate foreign E&P deficit exceeds the aggregate of its pro rata share of its SFCs' post-1986 E&P. An affiliated group's aggregate unused E&P deficit is allocated to each group member based on the relative amount of each member's deferred income. Note that these rules which mandate netting first within a chain owned by a single

KPMG observation

The new law requires computation of post-1986 E&P without regard to certain current year dividends. In particular, it is clear that dividends paid by an SFC to its U.S. shareholders during the mandatory repatriation year fail to reduce the E&P available for mandatory repatriation (although such E&P may be converted to PTI and thus not taxed upon receipt).

The new law's definition of post-1986 E&P only includes E&P of a foreign corporation accumulated during periods when the foreign corporation was an SFC. The new law does not, however, define post-1986 E&P by reference to the period that a U.S. shareholder has directly or indirectly owned an SFC. Thus, it appears that a U.S. shareholder must include its pro rata share of an SFC's post-1986 E&P that accumulated during periods the foreign corporation was an SFC as a result of another U.S. shareholder's ownership.

The new law recognizes that basis adjustments to the stock of SFCs may be necessary to account for a U.S. shareholder's inclusion of deferred income or such shareholder's use of a SFC's deficit to offset deferred income. The new law anticipates that the Treasury will issue regulations that will address the timing of adjustments to the basis of the stock of SFCs. These anticipated regulations would appear to be aimed at alleviating the potential for gain recognition on the distribution of amounts treated as PTI as a result of the transition rule. The new law also anticipates regulations that will reduce the basis of SFCs with deficits.

shareholder and then across to chains owned by other members of an affiliated group appear to be changed within consolidation by the rule announced in Notice 2018-07 that would treat all members of the consolidated group as a single U.S. shareholder. The transition rule includes a rule that adjusts the application of these affiliated group “netting” rules to group members that are not wholly owned (measured by value) within the group.

The new law provides a special rule for REITs that excludes deferred foreign income from a REIT’s gross income for purposes of the 95% and 75% gross income tests of section 856(c). Additional details with respect to this provision can be found in the REIT discussion in this report.

Participation exemption

Under the new law’s participation exemption, a U.S. shareholder is taxed at reduced rates on its mandatory inclusion. The portion of the inclusion attributable to the U.S. shareholder’s aggregate foreign cash position is taxed at 15.5% and the remaining portion is taxed at 8%. The participation exemption uses a deduction to achieve these reduced rates. The amount of a U.S. shareholder’s deduction is the sum of the amounts necessary to tax its mandatory inclusion attributable to its aggregate foreign cash position at 15.5% and the remaining portion at 8% using the highest corporate tax rate in effect for the year of the inclusion.

A U.S. shareholder’s “aggregate foreign cash position” is the greater of: (i) the aggregate of its pro rata share of its SFCs’ cash positions as of the close of their last tax year beginning before January 1, 2018; or (ii) one half of the aggregate of its pro rata share its SFCs’ cash positions as of the close of their last two tax years ending before November 2, 2017. An SFC’s “cash position” generally is the sum of its cash, net accounts receivable, and fair market value of certain other liquid assets (e.g., actively traded personal property, commercial paper, certificates of deposit, government securities, short-term obligations, and foreign currency). In Notice 2018-07, the IRS clarified that accounts receivable or payable and short term obligations between related SFCs will be disregarded to the extent that the SFCs share common ownership under a U.S. shareholder (thus following the consolidation regime). The Notice also notes that certain financial instruments and derivatives (e.g., notional principal contracts, options, forwards, etc.) will be identified as cash equivalents in forthcoming regulations but that such regulations will include exceptions for “bona fide hedging transactions.”

The new law includes a “double counting” rule that prevents a U.S. shareholder from taking into account the cash position of an SFC attributable to the SFC’s net accounts receivable, actively traded personal property, or short-term obligations, if the U.S. shareholder demonstrates to the satisfaction of the Secretary that it takes into account such amount with respect to another SFC. Noncorporate entities are treated as SFCs for purposes of determining a U.S. shareholder’s aggregate foreign cash position if an SFC owns an interest in the entity and the entity would be treated as an SFC of the U.S. shareholder if it was a foreign corporation. The determination of a U.S. shareholder’s aggregate foreign cash position is subject to an anti-abuse rule. Notice 2018-07 sets forth a series of examples that highlight the types of transactions resulting in double-counting or double non-counting that will be mitigated through forthcoming regulations.

KPMG observation

The new law ties the calculation of its deduction to the corporate income tax rate, even though its deduction applies to corporate and noncorporate U.S. shareholders. It is possible that section 962 may be elected by individual U.S. shareholders to mitigate this negative impact.

As noted above, amounts included by U.S. shareholders under the transition rule and post-1986 E&P of SFCs that are reduced by deficits are treated as PTI for purposes of section 959. Foreign currency movements between the date PTI is created and the date of distribution may generate foreign currency gains and losses under section 986(c). The explanatory statement accompanying the conference agreement anticipates that the Treasury will provide regulations that will allow a similar participation exemption to reduce the amount of such gain or loss.

The new law provides a list of assets that are considered to be included in the U.S. shareholder's cash position. The new law does not provide that "blocked" assets (i.e., those that cannot be distributed under local law) are excluded from a U.S. shareholder's cash position.

The new law's double counting rule limits, but does not eliminate, the potential for the cash positions of a U.S. shareholder's SFCs to be double counted. For example, the new law's double counting rule does not appear to apply to short-term obligations between SFCs with different U.S. shareholders. Also, if a calendar-year-end U.S. shareholder has a calendar-year-

end SFC and a fiscal-year-end SFC, it appears that the U.S. shareholder's aggregate foreign cash position applies to the deferred income of both SFCs. Specifically, the U.S. shareholder determines its aggregate foreign cash position once, notwithstanding that it includes the deferred income of its calendar-year-end SFC in its tax year ending December 31, 2017, and the deferred income of its fiscal-year-end SFC in its tax year ending December 31, 2018. That is, it appears that for purposes of determining the rate at which its fiscal-year-end SFC's deferred income is taxed, the U.S. shareholder's aggregate foreign cash position is not reduced for the amount of its calendar-year-end SFC's deferred income that was already attributed to its aggregate foreign cash position. Notice 2018-07 provides a method to mitigate double counting of the aggregate cash position when a U.S. shareholder holds interests in SFCs with respect to which the section 965 inclusion will occur in different taxable years (e.g., a calendar year U.S. shareholder owning both 11/30 and 12/31 year-end SFCs). Specifically, the aggregate foreign cash position that is taken into account in the inclusion year will be the lesser of the U.S. shareholder's aggregate foreign cash position in or aggregate section 965(a) inclusion in that taxable year. Further, in determining a U.S. shareholder's aggregate cash position, any amount taken into account in a subsequent taxable year will be reduced by the amount taken into account in the preceding taxable year.

KPMG observation

The new law allows foreign income taxes associated with the taxable portion of a U.S. shareholder's mandatory inclusion to offset the U.S. tax on such amount. The new law "haircuts" the foreign tax credits associated with a U.S. shareholder's mandatory inclusion by 55.7% for foreign income taxes associated with the portion of the inclusion attributable to the shareholder's aggregate foreign cash position and 77.1% for foreign income taxes associated with the other portion of the inclusion. These percentages are equal to the amount of the U.S. shareholder's mandatory inclusion that is offset by the participation exemption that is calculated using a corporate tax rate of 35%. As noted above, the amount of the participation exemption may be reduced to the extent that the corporate tax rate is 21% for the tax year of the mandatory inclusion; however, the amount of disallowed FTCs does not appear to be similarly adjusted. Additionally, a U.S. shareholder's section 78 gross-up appears to exceed the amount of foreign taxes allowed as a credit when the corporate tax rate is 21% because, although the amount of the haircut remains unchanged, the amount of foreign taxes attributable to the U.S. shareholder's net mandatory inclusion would increase due to a reduction in the amount of the participation exemption. As a result, it appears that the net impact on US tax liability ought to be the same whether an amount is included in income during 2017 or during 2018.

The new law does not address the use of foreign tax credit carryforwards to offset a U.S. shareholder's mandatory inclusion or the carryforward of foreign tax credits not used in the tax year in which a U.S. shareholder takes into account its mandatory inclusion. Thus, it appears that the current rules regarding foreign tax credit carryforwards apply to the transition rule. As a result, it appears that a U.S. shareholder can use existing foreign tax credit carryforwards against its mandatory inclusion and the foreign tax credit carryforward period remains 10 years.

Foreign tax credits

The new law allows the use of foreign income taxes associated with the taxable portion of the mandatory inclusion. Foreign tax credits are disallowed to the extent that they are attributable to the portion of the mandatory inclusion excluded from taxable income pursuant to the participation deduction (55.7% of the foreign taxes paid attributable to the cash portion of the inclusion taxed at 15.5%; 77.14% of the foreign taxes paid attributable to the noncash portion of the inclusion taxed at 8%). Foreign tax credits disallowed may not be taken as a deduction. The U.S. shareholder's section 78 gross-up is equal to the portion of the foreign taxes attributable to the U.S. shareholder's net mandatory inclusion (i.e., the foreign taxes attributable to the gross mandatory inclusion less such taxes attributable to the participation deduction).

Overall foreign loss recapture

The conference report did not discuss the impact of the mandatory inclusion on a U.S. shareholder's overall foreign loss (OFL) or separate limitation losses (SLLs).

Net operating loss election

The new law allows taxpayers to elect out of using net operating losses (NOLs) to offset the mandatory inclusion from the bill's transition rules. This rule allows taxpayers to avoid reducing their foreign source income from the mandatory inclusion to preserve the use of foreign tax credits in such year and it allows taxpayers to preserve their NOLs for future use.

Payment

The new law provides that the tax assessed on a U.S. shareholder's mandatory inclusion is payable in the same manner as its other U.S. federal income taxes and that such tax assessed may be paid over an eight-year period. The new law requires that 8% of the tax be paid in each of the first five years, 15% in the sixth year, 20% in the seventh year, and 25% in the eighth year. Only the U.S. federal income tax due on the mandatory inclusion is eligible to be paid in installments. The new law would accelerate the payment of the tax upon the occurrence of certain "triggering events," which include an addition to tax for failure to timely pay any installment due, a liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 case), or a cessation of business by the taxpayer to the date of such triggering event. The new law does not provide for any exceptions to acceleration.

The new law allows REITs to distribute their deferred foreign income to their shareholders over an eight-year period using the same installment percentages that apply to electing U.S. shareholders. Additional details with respect to this provision can be found in the REIT discussion in this report.

S corporations

The new law provides that if an S corporation is a U.S. shareholder of an SFC, each shareholder of the S corporation may elect to defer paying its net tax liability on its mandatory inclusion until its tax year that includes a “triggering event” with respect to the liability. A net tax liability that is deferred under this election appears to be assessed as an addition to tax in the electing shareholder’s tax year as the bill provides that the electing shareholder (and the S corporation) would be liable, jointly and severally, for the net tax liability and related interest or penalties.

A “triggering event” for purposes of this provision includes the corporation ceasing to be an S corporation; a liquidation or sale of substantially all of the assets of such S corporation; a cessation of business by such S corporation; such S corporation ceasing to exist or similar circumstances; and a transfer of any share of stock of the S corporation (including by death or otherwise), except that the transfer is not a triggering event if the transferee enters into an agreement with the Secretary under which the transferee is liable for net tax liability with respect to the stock. However, if the transfer is a triggering event (because the transferee does not assume the tax liability), then it is a triggering event only with respect to so much of the net tax liability as is properly allocable to the transferred stock.

An S corporation shareholder that elects to defer paying its net tax liability under the new law’s transition rule may also elect to pay this liability in equal installments over an eight-year period after a triggering event has occurred. However, this election is available only with the consent of the Secretary if the triggering event is a liquidation, sale of substantially all of the S corporation’s assets, termination of the S corporation or cessation of its business, or a similar event. The first installment must be paid by the due date (without extensions) of the shareholder’s U.S. federal income tax return for the year that includes the triggering event.

If any S corporation shareholder elects to defer paying its net tax liability, the S corporation is jointly and severally liable for the payment of the deferred tax as well as any penalty, additions to tax, or additional amounts attributable thereto, and the limitation on collection is not treated as beginning before the triggering event.

KPMG observation

The new law provides a deferral election that is available only to shareholders of S corporations that hold the S corporation stock at the time of the mandatory repatriation of deferred foreign income. This applies generally to S corporations that held stock in a CFC or SFC as of December 31, 2017, in situations where the CFC or SFC has income that has not been included in the shareholder’s income (i.e., deferred foreign income). The S corporation shareholders can elect to defer tax on the inclusion until a “triggering event.” As a result of the deferral election, there is potentially a very lengthy deferral on the tax on the repatriation income. Once a triggering event occurs, the shareholder who elected deferral can then choose to use the 8-year installment method to pay the tax.

KPMG observation

For purposes of the new law's recapture rules, an "expatriated entity" is a domestic corporation or domestic partnership the assets of which are acquired by a "surrogate foreign corporation," which is not treated as a domestic corporation under section 7874(b), in a "domestic entity acquisition" and any U.S. person related to such domestic corporation or domestic partnership under sections 267(b) or 707(b)(1). A domestic entity acquisition occurs when a foreign corporation directly or indirectly acquires substantially all of the properties directly or indirectly held by a domestic corporation or substantially all of the properties constituting a trade or business of a domestic partnership. A foreign corporation is a surrogate foreign corporation that is not a domestic corporation under section 7874(b) if it completes a domestic entity acquisition and in the acquisition, the former shareholders of the domestic corporation or former partners of the domestic partnership, as applicable, receive at least 60% but less than 80% of the vote or value of the foreign corporation's stock "by reason of" (e.g., in exchange for or with respect to) their domestic corporation stock or domestic partnership interests, as applicable, and after the acquisition does not have substantial business activities in its country of creation or organization. The U.S. anti-inversion rules are extremely complex and include many ambiguous provisions.

The incorporation of the U.S. anti-inversion rules complicates the new law's transition rule and could have unintended consequences. In particular, because the definition of expatriated entity includes U.S. persons that share a section 267(b) or 707(b)(1) relationship with the target entity in a domestic entity acquisition, the new law's inversion recapture rules may apply to U.S. shareholders other than the target entity. Given the punitive treatment of the amounts subject to the new law's inversion recapture rules, the rules likely would be an important diligence item for future merger and acquisition transactions.

Recapture from expatriated entities

The new law includes recapture rules that are intended to deter inversions. Under these rules, if a U.S. shareholder becomes an "expatriated entity" within the meaning of section 7874(a)(2) at any point during the 10-year period following the enactment of the bill, (i) the shareholder would be denied a participation deduction with respect to its mandatory inclusion, (ii) the shareholder's mandatory inclusion would be subject to a 35% tax rate, and (iii) the shareholder would not be able to offset the additional U.S. federal income tax imposed by the recapture rules with foreign tax credits. An entity that becomes a domestic corporation under section 7874(b) is not subject to these recapture rules. The additional tax from these recapture rules arises in, and is assessed for, the tax year in which the U.S. shareholder becomes an expatriated entity.



Rules related to passive and mobile income

Current-year inclusion of global intangible low-taxed income by United States shareholders

Section 14201 of the new law adds Code section 951A, which requires a U.S. shareholder of a CFC to include in income its "global intangible low-taxed income" (GILTI) in a manner similar to subpart F income. Corporate shareholders generally are allowed a deduction equal to 50% of GILTI, which will be reduced to 37.5% starting in 2026. In general, GILTI is determined at the U.S. shareholder level as the excess of all CFCs' net income over a deemed return on tangible assets.

In general, when a U.S. person is (i) a 10% U.S. shareholder of a CFC (taking into account the broad constructive ownership rules applicable in subpart F) on any day during the CFC's tax year during which the foreign corporation is a CFC; and (ii) the U.S. person owns a direct or indirect interest in the CFC on the last day of the tax year of the foreign corporation on which it is a CFC (without regard to whether the U.S. person is a 10% shareholder on that day), then the U.S. person would be required to include in its own income its pro rata share of the GILTI amount allocated to the CFC for the CFC's tax year that

ends with or within its own tax year. A U.S. shareholder would increase its basis in the CFC stock for the GILTI inclusion, which generally would be treated as “previously taxed income” for subpart F purposes.

GILTI. In general, GILTI is described as the excess of a U.S. shareholder’s “net CFC tested income” over its “net deemed tangible income return,” which is defined as 10% of its CFCs’ “qualified business asset investment,” reduced by certain interest expense taken into account in determining net CFC tested income.

Under the new law, the full amount of GILTI is included in a U.S. shareholder’s income. Corporate shareholders are allowed a deduction equal to 50% of GILTI for 2018 through 2025, which will be decreased to 37.5% beginning in 2026. As a result, the effective tax rate on GILTI when a shareholder is allowed the 50% deduction would be 10.5%⁹ prior to 2026. The deduction for GILTI is limited when the GILTI inclusion and FDII (described below) exceed the corporation’s taxable income, determined without regard to the GILTI and FDII deductions. Because the GILTI deduction is limited by taxable income, net operating losses would be absorbed against the gross amount of GILTI before any GILTI deduction is allowed, and there is no carryforward for the foregone portion of any GILTI deduction due to the limitation to taxable income.

KPMG observation

Similar to other amounts calculated under subpart F, the GILTI amount is included in a U.S. shareholder’s income each year without regard to whether that amount was distributed by the CFC to the U.S. shareholder during the year.

Although lowering the U.S. statutory rate from 35% to 21% presumably reduces the incentives to erode the U.S. tax base by shifting profits outside the United States, this provision reflects a concern that shifting to a territorial tax system could exacerbate base erosion incentives because any shifted profits could be permanently exempt from U.S. tax. The inclusion of GILTI in a U.S. shareholder’s income is intended to reduce those incentives further by ensuring that CFC earnings that exceed a deemed return on its tangible assets are subject to some measure of U.S. tax (at a rate potentially as low as 10.5% through 2025⁹ when the 50% deduction described above is allowed).

Both the reduction in the corporate tax rate and the exemption from income of dividends received from CFCs are described as increasing the competitiveness of U.S. corporations and levelling the playing field with foreign multinationals. It is worth noting that an immediate tax, which in many cases will be imposed on most of a CFC’s earnings, even at an effective rate of 10.5% for corporate shareholders (after taking into account the 50% deduction described above) would be comparatively unfavorable to the CFC regimes of most of the major trading partners of the United States, which typically tax CFC earnings in much more limited circumstances.

⁹ The effective tax rate on GILTI would be commensurately higher starting in 2026 after the GILTI deduction is reduced to 37.5%.

¹⁰ This effective rate would increase to 13.125% when the deduction is reduced in 2026.

KPMG observation

Although the interaction of the corporate-level GILTI deduction with Code section 962 is not entirely clear, reducing an electing shareholder's GILTI inclusion by the GILTI deduction would be consistent with treating the electing shareholder as a domestic corporation, which fits within the general framework of section 962.

KPMG observation

The net deemed tangible income return is determined by applying a 10% fixed rate of return to QBAI, and reducing the result by the interest expense taken into account in determining net CFC tested income, to the extent the interest income attributable to the expense is not taken into account in determining net CFC tested income. As a result, interest expense incurred between a U.S. shareholder's CFCs generally will not reduce the deemed return, but the deemed return will be reduced for interest expense incurred by a CFC as a result of debt owed to an unrelated person or to related CFCs that are owned outside the U.S. shareholder's chain. In many cases, the deemed return on tangible assets will be negligible, for example because (i) the CFC's primary value-driver is intangible assets (notably, no relief is given for a return on intangible assets even when a taxpayer has purchase basis in the assets); or (ii) the CFC's tangible property is substantially depreciated. In such cases, the tax base on which the tax is imposed may be a U.S. shareholder's ratable share of tested income without reduction for any exempt return.

Individual shareholders. Noncorporate U.S. shareholders generally are subject to full U.S. tax on GILTI inclusions, based on applicable rates. The new law clarifies that applicable U.S. shareholders can make a Code section 962 election with respect to GILTI inclusions, pursuant to which the electing shareholder would be subject to tax on the GILTI inclusion based on corporate rates, and would be allowed to claim FTCs on the inclusion as if the shareholder were a corporation.

Net CFC tested income. The new law defines "net CFC tested income" as, with respect to any U.S. shareholder for any taxable year, the excess of the shareholder's aggregate pro rata share of the tested income of each CFC for which the shareholder is a U.S. shareholder for such taxable year over the aggregate pro rata share of the tested loss of each such CFC. For this purpose, "tested income" of a CFC generally is described as the gross income of the CFC other than (i) ECI; (ii) subpart F income; (iii) amounts excluded from subpart F income under the Code section 954(b)(4) high-tax exception; (iv) dividends received from a related person (as defined in Code section 954(d)); and (v) foreign oil and gas extraction income, over deductions allocable to such gross income under rules similar to Code section 954(b)(5) (or to which such deductions would be allocable if there were such gross income). Tested loss is defined to mean the excess of deductions allocable to such gross income over the gross income.

Net deemed tangible income return. Under the new law, the "net deemed tangible income return" is defined as the excess of 10% of the aggregate of each CFC's qualified business asset investment (QBAI) 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 the expense is not taken into account in determining the shareholder's net CFC tested income. QBAI is determined as the average of the adjusted bases (determined at the end of each quarter of a tax year) in "specified tangible property" that is used in the production of tested income and that is subject to Code section 167 depreciation. The conference explanation states that specified tangible property would not include property used in the production of a tested loss, so a CFC that has a tested loss in a taxable year would not have any QBAI for that year.¹¹ For purposes of computing QBAI, the adjusted basis of property is determined under the alternative depreciation

¹¹Footnote 1536 of the Conference Report at page 642.

rules of Code section 168(g), and by allocating the depreciation deductions ratably to each day during the period in the tax year to which the depreciation relates.

Deemed-paid foreign tax credit. For any amount of GILTI that is includible in a U.S. corporate shareholder's income, the new law provides for a limited deemed paid credit of 80% of the foreign taxes attributable to the tested income (as defined above) of the CFCs. The foreign taxes attributable to the tested income are determined using an aggregate computation at the U.S. shareholder level, as the product of (i) the domestic corporation's "inclusion percentage," multiplied by (ii) the aggregate foreign income taxes paid or accrued by each of the shareholder's CFCs that are properly attributable to tested income of the CFC that is taken into account by the U.S. shareholder under section 951A. Thus, taxes attributable to a CFC that earns a tested loss for a taxable year do not appear to be taken into account.

The inclusion percentage is the ratio of the shareholder's aggregate GILTI divided by the aggregate of the shareholder's share of the tested income of each CFC. This ratio presumably is intended to compare the amount included in the U.S. shareholder's income and subject to tax in the United States (the GILTI), to the amount with respect to which the relevant foreign taxes are imposed (the tested income), to determine the relevant percentage of foreign taxes that should be viewed as deemed paid for purposes of the credit.

The new law computes the section 78 gross-up by reference to 100% of the related taxes, rather than by reference to the 80% that are allowable as a credit. Although the gross-up amount is included in income as a dividend, it is not eligible for the Code section 245A 100% DRD, but is eligible for the GILTI deduction.

In addition, the new law creates a separate basket for these deemed paid taxes to prevent them from being credited against U.S. tax imposed on other foreign-source income. Moreover, any deemed-paid taxes on GILTI are not allowed to be carried back or forward to other tax years.

These rules are effective for tax years of foreign corporations beginning after December 31, 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign corporations end.

According to JCT, the GILTI rules (including the GILTI deduction) will increase revenues by \$112.4 billion over 10 years.

KPMG observation

The conference report's explanatory statement includes a simple example illustrating the interaction of the 50% deduction with the 20% haircut on foreign tax credits, which concludes that U.S. tax would not be owed when the effective foreign tax rate on the underlying income is 13.125%. This conclusion is misleading for several reasons, including: (i) a taxpayer may not have sufficient income to take the full GILTI deduction, due to a current-year loss from other activities or an NOL carryforward; (ii) there will always be leakage of the foreign tax credit when there is at least one tested loss CFC because, although the GILTI inclusion is computed by allowing an offset for tested losses, the denominator of the "inclusion percentage" is the aggregate of all tested income without offset for tested losses; and (iii) taxpayers may be required to allocate expenses to the GILTI basket, precluding them from obtaining the full benefit of taxes paid with respect to their "tested income."

In addition, because there is no carryforward or other provision to mitigate the consequences of timing differences between U.S. and foreign income tax laws, it is possible that U.S. shareholders whose CFCs generally are subject to significant foreign taxes may nonetheless owe residual U.S. tax in a particular year if significant income is recognized in that year for U.S. tax purposes but not for foreign tax purposes. For large multinationals this issue may be mitigated by the ability to average across CFCs, but cyclical businesses nevertheless could be especially susceptible to this problem. Moreover, by precluding carryover, the new deemed FTC provision may put some taxpayers in a position where they are better off deducting rather than crediting the relevant foreign taxes they are deemed to pay under the provision.

To mitigate the impact of these rules in 2018, U.S. shareholders with a calendar year should consider electing a November 30 year-end for their CFCs, in which case the income of their CFCs would not be subject to the tax until December 1, 2018. In the case of a U.S. shareholder with a fiscal year, that U.S. shareholder generally would be exempt from the tax until the first day of the CFC's fiscal year beginning in 2018 (for example, a CFC with a September 30 year-end would become subject to the tax beginning October 1, 2018).

Illustration of GILTI computation from KPMG modeling tool

	2018	2019	2020
Global intangible Low-Tax Income (GILTI)			
Net CFC Tested Income	97.2	106.1	111.2
Applicable percentage allowed as a return on QBAI	10%	10%	10%
Amount of qualified business asset investment (QBAI)	32.0	34.0	70.0
Interest expense include in NCTI where matching interest income not in NCTI	-	-	-
Tentative GILTI includible in gross income	94.0	102.7	104.2
Sec. 78 gross-up on tentative GILTI	9.7	10.8	10.8
GILTI includible in gross income	103.7	113.5	115.0

Foreign tax credit on GILTI			
GILTI amount	94.0	102.7	104.2
Net CFC tested income	97.2	106.1	111.2
Aggregate net CFC tested losses	3.0	3.5	4.2
Gross tested income of CFCs (gross active annual non-US E&P)	100.2	109.6	115.4
Inclusion Percentage	93.8%	93.7%	90.3%
Gross tested income of CFCs, unreduced by non-US taxes	110.5	121.1	127.4
Blended ETR on all non-US E&P at CFCs with tested income	9.4%	9.5%	9.4%
Tested Foreign Income Taxes	10.3	11.5	12.0
Haircut percentage on tested foreign income taxes	80.0%	80.0%	80.0%
GILTI: Foreign tax credit amount	7.8	8.6	8.6

Add deduction for foreign-derived intangible income

In conjunction with the new minimum tax regime on excess returns earned by a CFC, the new law provides a 13.125% effective tax rate on excess returns earned directly by a U.S. corporation from foreign sales (including licenses and leases) or services, which would increase to 16.406% starting in 2026. Specifically, for tax years 2018-2025, the new law allows a U.S. corporation a deduction equal to 37.5% of its "foreign-derived intangible income" (FDII). Starting in 2026, the deduction percentage is reduced to 21.875%. The deduction for FDII is limited when the GILTI inclusion and FDII exceed the corporation's taxable income, determined without regard to the GILTI and FDII deductions. The deduction is not available for S corporations or domestic corporations that are RICs or REITs.

The new law contains complex rules for determining the amount of a U.S. corporation's FDII. At a high level, a U.S. corporation's FDII is the amount of its "deemed intangible income" that is attributable to sales of property (including licenses and leases) to foreign persons for use outside the United States or the performance of services to persons, or with respect to property, located outside the United States. A U.S. corporation's deemed intangible income generally is its gross income that is not attributable to a CFC or foreign branch, and which is not financial services income or domestic oil and gas extraction income, reduced by (i) related deductions (including taxes) and (ii) an amount equal to 10% of the aggregate adjusted basis of its tangible depreciable assets (other than assets that produce excluded categories of gross income, such as branch assets).

Thus, a domestic corporation is subject to the standard 21% tax rate to the extent of a fixed 10% return on depreciable assets and a 13.125% (increased to 16.406% as of 2026) tax rate on any excess return that is attributable to exports of goods or services.

The new law also includes special rules for foreign related-party transactions. A sale of property to a foreign related person does not qualify for FDII benefits unless the property is ultimately sold to an unrelated foreign person, or used by a related person in connection with sales of property or the provision of services to an unrelated foreign person for use outside the United States. A sale of property is treated as a sale of each of the components thereof. The provision of services to a foreign related person does not qualify for FDII benefits if the services are substantially similar to services provided by the foreign related person to persons located in the United States.

The provision is effective for tax years beginning after December 31, 2017.

KPMG observation

The preferential rate on deemed intangible income attributable to export activities presumably is intended to encourage U.S. corporations to keep (or relocate) production activities in the United States. Interestingly, under the new law, income earned from an active business conducted overseas would generally be taxed at full U.S. rates if undertaken in the form of a branch, while if conducted through a CFC the majority of the income would still be taken into account currently in the United States via the GILTI regime but would be eligible for tax at a reduced rate. It is not entirely clear why the law creates such incongruous treatment for activities conducted through a foreign branch as opposed to a CFC.

KPMG observation

While the repeal of section 954(g) of the Code would exclude foreign oil related income from subpart F income, the income may be subject to current U.S. taxation under the new “global intangible low-taxed income” (GILTI) rules, which effectively impose a minimum tax based, in part, on a CFC’s gross income, subject to certain exceptions. Although “foreign oil and gas extraction income” is excluded from GILTI, there is no similar exclusion for “foreign oil-related income.”

KPMG observation

A primary impact of this provision would be to cause minority U.S. owners of foreign subsidiaries in an inverted group to be treated as U.S. shareholders of CFCs as a result of attribution from the majority foreign owner. These residual owners would become subject to the subpart F rules, including the new GILTI rules. Nonetheless the downward attribution of ownership from foreign persons can have broader implications than the de-controlling transactions that the provision aims to render ineffective. For example, the foreign subsidiary of a foreign corporation that also owns a U.S. subsidiary could be treated as a CFC solely as a result of downward attribution from the foreign parent corporation to the U.S. subsidiary. In that case, a 10% U.S. owner of the foreign parent corporation could be treated as the owner of the foreign subsidiary CFC. This provision applies to the last tax year beginning before January 1, 2018, and thus applies for purposes of the mandatory repatriation provision.



Other modifications of subpart F provisions

Eliminate inclusion of foreign base company oil-related income

Section 14211 of the new law repeals section 954(g) of the Code. As a result, there would no longer be full U.S. tax currently imposed on foreign oil-related income of a foreign subsidiary.

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

The JCT has estimated that this provision would reduce revenues by approximately \$4 billion over 10 years.

Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment

Section 14212 of the new law repeals section 955 of the Code. As a result, there no longer is current U.S. tax imposed on previously excluded foreign shipping income of a foreign subsidiary if there was a net decrease in qualified shipping investments.

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

According to the JCT, this provision will reduce revenues by less than \$50 million over 10 years.

Modification of stock attribution rules for determining status as a controlled foreign corporation

Section 14213 of the new law eliminates a constructive ownership rule in section 958(b)(4) of the Code that prevents downward attribution of stock owned by a foreign person to a U.S. person. As a result, for example, stock owned by a foreign corporation would be treated as constructively owned by its wholly owned domestic subsidiary for purposes of determining the U.S. shareholder status of the subsidiary and the CFC status of the foreign corporation.

The provision applies to the last tax year of foreign corporations beginning before January 1, 2018, and all subsequent tax years of a

foreign corporation, and for the tax years of U.S. shareholders in which or with which such tax years of foreign corporations end.

According to the JCT, this provision, along with the deduction for dividends received, would reduce revenues by approximately \$223.6 billion over 2018-2027. This provision alone, though, likely would increase revenues as a result of expanding the scope of taxpayers subject to the subpart F rules.

Modification of definition of U.S. shareholder

Section 14214 of the new law revises the definition of U.S. shareholder in section 951(b) of the Code to include a U.S. person who owns at least 10% of the value of the shares of the foreign corporation. As a result of this provision, a U.S. person would be treated as a U.S. shareholder of a foreign corporation for subpart F purposes when the person owns at least 10% of either the voting power or the value of the foreign corporation.

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

According to the JCT, this provision will increase revenues by approximately \$1.3 billion over 10 years.

Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply

Section 14215 of the new law eliminates the requirement in section 951(a) of the Code for a foreign corporation to constitute a CFC for an uninterrupted period of at least 30 days in order for a U.S. shareholder to have a current income inclusion. As a result, for example, a U.S. shareholder could have a current subpart F inclusion when a CFC generates subpart F income during a short tax year of less than 30 days.

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

According to the JCT, this provision will increase revenues by approximately \$600 million over 10 years.

KPMG observation

This provision increases the scope of U.S. persons who are required to include amounts in income under the subpart F rules and potentially increases the amount of subpart F income that current U.S. shareholders would be required to include in income, when the value of a shareholder's stock in a foreign corporation exceeds the voting power of the stock.

The new law provision is identical to a provision in the Senate bill. By expanding the scope of section 936(h)(3)(B), this provision would make it more difficult for a U.S. person to transfer intangible property outbound without incurring tax. The provision also resolves prospectively long-standing uncertainties regarding the scope of section 936(h)(3)(B) and, in particular, the application of section 367(d) to outbound transfers of goodwill, going concern value, and workforce in place. Although recent regulations under section 367 required that outbound transfers of goodwill and going concern value are taxable under section 367(a) or (d), the IRS expressly declined to address whether goodwill, going concern value, and work force in place are section 936(h)(3)(B) intangibles.



Prevention of base erosion

Adds limitations on income shifting through intangible property transfers

The new law amends the definition of intangible property in section 936(h)(3)(B) (which applies for purposes of sections 367(d) and 482) to include workforce in place, goodwill, going-concern value, and “any other item” the value or potential value of which is not attributable to tangible property or the services of an individual. The new law also removes the flush language of section 936(h)(3)(B), which limits section 936(h)(3)(B) to intangibles that have substantial value independent of the services of any individuals, to make clear that the source or amount of value of an intangible is not relevant to whether that type of intangible is within the scope of section 936(h)(3)(B).

Additionally, the new law clarifies the authority of the Commissioner to specify the method used to value intangible property for purposes of both the section 367(d) outbound transfer rules and the section 482 intercompany pricing rules. Specifically, when multiple intangible properties are transferred in one or more transactions, the IRS may value the intangible properties on an aggregate basis when that achieves a more reliable result. The law also codifies the realistic alternative principle, which generally looks to the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction undertaken.

The provision applies to transfers in tax years beginning after December 31, 2017. Additionally, the new law states that no inference is intended with respect to the application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application with respect to tax years beginning before January 1, 2018.

Limit deduction of certain related-party amounts paid or accrued in hybrid transactions or with hybrid entities

The new law disallows a deduction for any disqualified related-party amount paid or accrued pursuant to a hybrid transaction, or by, or to, a hybrid entity.

A disqualified related-party amount is any interest or royalty paid or accrued to a related party if (i) there is no corresponding income inclusion to the related party under local tax law or (ii) such related party is allowed a deduction with respect to the payment under local tax law. A disqualified related-party amount does not include any payment to the extent such payment is included in the gross income of a U.S. shareholder under section 951(a) (i.e., a “subpart F” inclusion). A related party for these purposes is determined by applying the rules of section 954(d)(3) to the payor (as opposed to the CFC referred to in such section).

A hybrid transaction is any transaction, series of transactions, agreement, or instrument under which one or more payments are treated as interest or royalties for federal income tax purposes but are not so treated for purposes of the tax law of the foreign country of which the entity is resident or is subject to tax.

A hybrid entity is one that is treated as fiscally transparent for federal income tax purposes (e.g., a disregarded entity or partnership) but not for purposes of the foreign country of which the entity is resident or is subject to tax (hybrid entity), or an entity that is treated as fiscally transparent for foreign tax law purposes but not for federal income tax purposes (reverse hybrid entity).

The new law also grants the Secretary authority to issue regulations or other guidance necessary or appropriate to carry out the purposes of the provision and sets forth a broad list of issues such guidance may address. Such guidance may provide rules for the following (1) denying deductions for conduit arrangements that involve a hybrid transaction or a hybrid entity; (2) applying the provision to branches or domestic entities; (3) applying the provision to certain structured transactions; (4) denying some or all of a deduction claimed for an interest or a royalty payment that, as a result of the hybrid transaction or entity, is included in the recipient's income under a preferential tax regime of the country of residence of the recipient and has the effect of reducing the country's generally applicable statutory tax rate by at least 25%; (5) denying a deduction claimed for an interest or a royalty payment if such amount is subject to a participation exemption system or other system that provides for the exclusion of a substantial portion of such amount; (6) determining the tax residence of a foreign entity if the entity is otherwise considered a resident of more than one country or of no country; (7) exceptions to the provision's general rule to (a) cases in which the disqualified related-party amount is taxed under the laws of a foreign country other than the country of which the related party is a resident for tax purposes, and (b) other cases that the Secretary determines do not present a risk of eroding the U.S. income tax base; and (8) requirements for record keeping and information reporting in addition to any requirements imposed by section 6038A.

The provision is effective for tax years beginning after December 31, 2017 and does not appear to contain grandfathering rules.

KPMG observation

The new law attempts to neutralize the effects of hybrid mismatch arrangements by denying deductions for interest and royalty payments made to related parties under hybrid arrangements that give rise to income that is not taxed in any jurisdiction (stateless income). Similar proposals have been included as part of President Obama's FY 2017 Budget Proposal and in the recommendations issued pursuant to Action 2 of the OECD BEPS project (Recommendations).

The new law's provision is written broadly and would appear to apply to many of the transactions and structures addressed by the Recommendations, including the use of hybrid instruments and payments to and from reverse hybrids and disregarded payors. For example, an interest payment made with respect to a hybrid financial instrument held by a related party could be affected if there is no corresponding income inclusion by the related party.

The new law does not appear to be limited to interest or royalties paid by a U.S. payor and may apply to such payments made by a U.S. person or a non-U.S. person, including payments between foreign related parties.

Other portions of the Recommendations may be implemented through Treasury Regulations. These provisions could include rules that apply to imported mismatch arrangements, branch structures or domestic entities, and deductible dividends that are excluded pursuant to a participation exemption. The explanatory statement accompanying the conference agreement anticipates that the Treasury will issue regulations that apply the provision to branches (domestic or foreign) and domestic entities even if such entities do not meet the statutory definition of a hybrid entity. As a result, interest or royalty payments by a U.S. LLC that has elected corporate status for U.S. tax purposes to its foreign parent could be affected under regulations if the foreign parent does not have an income inclusion as a result of the U.S. LLC being treated as disregarded under the tax laws of the country of the foreign parent.

Hybrid entities also potentially implicate the dual consolidated loss rules. Specifically, a domestic corporate owner of a foreign hybrid entity is subject to the dual consolidated loss rules, if the foreign hybrid entity incurs a loss for U.S. tax purposes. The new law does not alter the dual consolidated loss rules.

KPMG observation

The repeal of section 902 of the Code may have significant consequences for domestic corporations eligible to claim section 902 deemed-paid credits with respect to dividends from 10%-owned foreign corporations that are not CFCs because foreign income taxes paid or accrued by such corporations could no longer be claimed as FTCs. Moreover, the change from the pooling regime to a current-year foreign tax regime could also significantly affect the foreign tax credit calculation, as the pooling regime serves to blend effective foreign tax rates that may differ from year to year due to U.S. and foreign timing differences and rate changes.

Surrogate foreign corporations not eligible for reduced rate on dividends

The new law's anti-base erosion provisions include a rule that prevents dividends from surrogate foreign corporations to individuals from qualifying for the reduced tax rate applicable to qualified dividends. This rule only applies to corporations that first become surrogate foreign corporations after the bill is enacted and are not treated as a domestic corporation under section 7874(b).

This rule is effective for dividends received after the date of enactment (i.e., December 22, 2017).



Modifications related to foreign tax credit system

Repeal section 902 indirect foreign tax credits; determination of section 960 credit on a current-year basis

The new law repeals the deemed paid foreign tax credit under section 902 of the Code and retains but modifies the deemed paid foreign tax credit under section 960 of the Code.

Section 902 of the Code deems a U.S. corporate shareholder of a 10%-owned foreign corporation to have paid a portion of the foreign corporation's foreign income taxes when it receives or is deemed to receive a dividend from that foreign corporation. Section 960 of the Code provides a similar deemed paid credit for subpart F inclusions. Under the new law, the allowable credit under section 960 of the Code is based on current-year taxes attributable to subpart F income rather than the "pooling" approach that applied under sections 902 and 960.

The new law also provides rules applicable to foreign taxes attributable to distributions of previously taxed income (PTI), including from a lower-tier to an upper-tier CFC. These rules are not explained in any further detail, but appear to allow foreign taxes as credits under section 960 in the year the PTI is distributed. The new law grants the Secretary authority to promulgate regulations and guidance such that the amended section 960 credit would, as under pre-enactment law, be computed separately for each category or "basket" of income under Code section 904(d).

The new law makes conforming amendments to other Code provisions to reflect the repeal of Code section 902, including amending Code section 78 to treat the "gross-up" for deemed paid taxes as a dividend.

The amendments are effective for tax years of foreign corporations beginning after 2017 and to tax years of United States shareholders with or within which such tax years of foreign corporations end.

Separate foreign tax credit limitation basket for foreign branch income

The new law creates a new foreign tax credit limitation basket for foreign branch income. Under the provision, foreign branch income is a U.S. person's business profits attributable to one or more qualified business units (QBUs) in one or more countries. Generally, a QBU is defined in section 989 of the Code as "any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records." The new law grants the Secretary the authority to establish rules for determining what constitutes "business profits"; however, the legislation explicitly excludes passive income from the definition.

This provision is effective for tax years beginning after 2017.

Determine source of income from sales of inventory solely on basis of production activities

The new law revises the general rule under Code section 863(b), which sources income from inventory property produced in one jurisdiction and sold in another jurisdiction by allocating 50% of sales income to the place of production and 50% to the place of sale (determined based on title passage). Under the revised provision, income from inventory sales would be sourced entirely based on the place of production. Thus, if inventory property is produced in the United States and sold outside the United States, sales income would be 100% U.S. source. If inventory property is produced partly within and partly without the United States, income from the sales would be partly U.S. source and partly foreign source.

According to the JCT, this provision will increase revenues by approximately \$500 million over 10 years.

This provision is effective for tax years beginning after 2017.

KPMG observation

Similar to creating a separate basket for GILTI, as discussed below, this provision would operate to prevent cross-crediting of foreign taxes attributable to low-tax subpart F income with those attributable to high-tax branch income. It apparently would also prevent general limitation foreign tax credit carryforwards from pre-effective date years from offsetting the U.S. tax on such branch income.

KPMG observation

The change eliminates the beneficial title passage rule of pre-enactment law and replaces it with a rule that is meant to reflect solely the economics of production. The provision eliminates a significant means under pre-enactment law for generating general limitation foreign source income. It could also have the unintended result of encouraging companies to expand foreign production.

KPMG observation

It will be more challenging under the new law for taxpayers with foreign tax credit carryovers from pre-effective date years to utilize those credits given the creation of new foreign tax credit limitation baskets for GILTI and branch income, as described above. The ODL election allows taxpayers to accelerate the use of those credits in years subsequent to enactment of the new law by recharacterizing a greater amount of U.S. source income as foreign source (and typically general limitation) income for foreign tax credit purposes.

KPMG observation

The BEAT includes within its scope almost every outbound payment made by corporations subject to the rule, except for payments treated as COGS or otherwise as reductions to gross receipts (subject to regulatory authority for the Secretary to write anti-avoidance regulations). This limited exception is unavailable for taxpayer groups that “invert” after November 9, 2017. Other than for such inverted groups, the BEAT therefore does not apply, for example, to payments for inventory manufactured outside the United States.

Amend section 904(g) to allow increased overall domestic loss recapture

The new law modifies the overall domestic loss (ODL) recapture rules of section 904(g) to allow taxpayers to elect to recapture a pre-2018 unused ODL for any “applicable tax year” by substituting a percentage greater than 50% (but not greater than 100%) in section 904(g)(1). An applicable tax year is any tax year of the taxpayer beginning after December 31, 2017 and before January 1, 2028. Under section 904(g)(1), a taxpayer with an ODL account recaptures an amount not greater than 50% of its U.S. source taxable income for a tax year (limited to the amount of its ODL account) and treats such income as foreign source income for foreign tax credit purposes. The election would thus allow taxpayers to recapture their ODL accounts, and recharacterize U.S. source income as foreign source income, more rapidly than under pre-enactment law.

According to the JCT, this provision will decrease revenues by approximately \$2.3 billion over 10 years.

Limit foreign tax credits for global intangible low-taxed income

The new law adds a new FTC basket for taxes associated with “global intangible low-taxed income.” For more details regarding those rules, see the discussion of global intangible low-taxed income in the “Rules related to passive and mobile income” section above.



Inbound provisions

Add base erosion and anti-abuse tax (BEAT)

The final sentence in the “Unified Framework” released by Republican leadership on September 27 was an opaque statement that “the committees will incorporate rules to level the playing field between U.S.-headquartered parent companies and foreign-headquartered parent companies.” The new law implements this principle by creating a new base-erosion-focused minimum tax (the base erosion and anti-abuse tax or BEAT) that in many cases would significantly curtail the U.S. tax benefit of cross-border related-party payments made by large multinationals.

Scope—Applicable taxpayers making base erosion payments

The BEAT applies to domestic corporations that are not taxed on a flow-through basis (that is, not S Corps, RICs, or REITs), are part of a group with at least \$500 million of annual domestic (including effectively connected amounts earned by foreign affiliates) gross receipts (over a three-year averaging period), and which have a “base erosion percentage” (discussed below) of 3% or higher for the tax year (or 2% for certain banks and securities dealers, which are also subject to a higher BEAT rate, as discussed below). The provision also applies to foreign corporations engaged in a U.S. trade or business for purposes of determining their effectively connected income tax liability.

The targeted base erosion payments generally are amounts paid or incurred by the taxpayer to foreign related parties for which

a deduction is allowable, and also include amounts paid in connection with the acquisition of depreciable or amortizable property from the foreign related party. The new law also specifically includes cross-border reinsurance payments as base erosion payments. This category includes any premium or other consideration paid that is taken into account as a reduction in either life insurance gross income under section 803(a)(1)(B) or insurance company taxable income under section 832(b)(4)(A). Finally, for taxpayers that after November 9, 2017, become part of an “inverted” group, determined by reference to section 7874, base erosion payments also include “any amount that constitutes reductions in gross receipts” of the taxpayer when paid to the surrogate foreign corporation or any member of its expanded affiliated group.

There are two main exceptions to the provision’s scope for otherwise deductible payments. The first is for any “amount” paid or incurred for services that qualify “for use of the services cost method under section 482 (determined without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure)” and that reflects the total cost of the services without markup. The second is for “qualified derivative payments” for taxpayers that annually recognize ordinary gain or loss (e.g., mark to market) on such instruments, and subject to several exceptions.

The definition of a foreign related party is drawn from section 6038A and includes any 25% foreign shareholder of the taxpayer, related persons thereto, and any other person related to the taxpayer under the section 482 rules.

Payments that are treated as full inclusion subpart F income or as GILTI may also be fully subject to the BEAT, even though there may be no net tax benefit for payments subject to full inclusion and only a reduced tax benefit for payments included in GILTI. Although the threshold of deductible payments to foreign affiliates that is necessary for the BEAT to become a positive tax liability may not be met for many U.S.-headquartered companies, the provision requires careful maintenance and may affect companies that, for example, subcontract to or otherwise make significant deductible services payments to their foreign subsidiaries.

The provision is expected to affect certain industries disproportionately. In particular, with the explicit inclusion of related-party cross-border reinsurance, which is very common within the insurance industry, large segments of the insurance market could be very significantly impacted.

The exception for services that qualify for the services cost method is ambiguous. The services cost method is entirely a product of regulations (Reg. section 1.482-9) and other administrative guidance, and includes a number of requirements. In addition to a general exclusion for services that contribute significantly to the risks of business success or failure, which the new law explicitly turns off, the guidance includes a number of additional requirements, including numerous categories of services that are ineligible as “excluded activities.” It is unclear whether Congress intends for these additional regulatory exclusions to apply. It is also unclear what effect future regulatory changes may have on the availability of the exception, though providing a reference to the existing services cost method may indicate that only the current rules are intended to apply for purposes of the exception. In practice, many services contracts that could otherwise qualify for the services cost method nevertheless include a mark-up, which is often required by the transfer pricing rules in the foreign recipient’s jurisdiction. It appears based on a Senate floor colloquy that it may be intended that taxpayers can implement “self-help” in these cases by restructuring the contracts into separate “cost” and “profit” component payments and qualify the cost portion for the exception.¹² Whether this option is confirmed in future guidance, or whether Treasury interprets the rule to provide for this economic result without requiring taxpayers to alter their business affairs to achieve it (which would be an easier solution but has not been foreshadowed), would significantly affect the utility of the exception.

The exception for qualified derivative payments was reported as a significant concession to the financial services industry. Banks and securities dealers are otherwise treated less favorably in that they are subject to higher BEAT tax rates and a lower base erosion percentage de minimis threshold.

¹²Congressional debate: 163 Cong. Rec. S7697 (daily ed. December 1, 2017) (statements of Sen. Portman (OH) and Sen. Hatch (UT)).

KPMG observation

The addback for the BEAT occurs in the year the deduction is allowed. As a result, base erosion payments that are capitalized into depreciable or amortizable basis are taken into account as the capitalized costs are recovered.

Furthermore, the focus on allowed deductions indicates that an amount must otherwise be deductible after the application of other limitations before it is taken into account as a base erosion tax benefit. For interest expense, the new law confirms this point but also includes an unfavorable “stacking” rule for taxpayers that pay both unrelated and related-party interest in a given year. The stacking rule requires taxpayers to treat the limitation imposed under section 163(j) attributable entirely to unrelated party interest to the extent thereof. Thus, for example, if a taxpayer has \$100 of interest expense in a given year, \$60 of which is paid to related parties and \$40 to unrelated parties, and the taxpayer is allowed to deduct only \$70 under section 163(j), the entire \$60, rather than only a proportionate amount (e.g., 70%), is subject to the BEAT.

The general effective date provisions (see *infra*) apply to base erosion payments that are paid or accrued in tax years beginning after December 31, 2017. Plainly, no part of an NOL arising in a year prior to that effective date could arise from an amount paid or accrued after the effective date. Thus, unless a retroactive effect was intended, the base erosion percentage of any pre-effective date NOL ought to be zero when absorbed in post-enactment years. Nevertheless, the provision’s use of “any tax year” in defining the base erosion percentage and the definition of modified taxable income could be interpreted to mean that pre-effective year NOL deductions are subject to the BEAT as “add-backs” when absorbed in post-enactment years. That the provision does not clearly address whether the base erosion percentage for an NOL carryover deduction is determined in the year the NOL arises, or when absorbed, contributes to the ambiguity. These are among the many points that await confirmation in future developments.

Base erosion payments are subject to the provision when they give rise to a “base erosion tax benefit,” meaning the tax year in which a deduction for the payment is allowed. If base erosion payments form part of a net operating loss (NOL), the base erosion tax benefit is taken into account as part of the section 172 deduction in the carryback or carryover year.

For base erosion payments that are subject to Chapter 3 withholding, the payment is not subject to the rule (that is, it is not added back to modified taxable income, as discussed below). For payments that are subject to a reduced rate of withholding under a Treaty, the exclusion is done proportionately in comparison to the statutory withholding rate.

The base erosion percentage used for the 3% (or 2%) threshold requirement, and for the portion of an NOL deduction that is taken into account, is determined by dividing the aggregate amount of base erosion tax benefits of the taxpayer for the tax year by the aggregate amount of the deductions allowable to the taxpayer for the year, but excluding NOLs, the participation exemption, the deduction allowed under new section 250 for foreign intangible income, and also any payments that qualify for the services cost method or qualified derivative exceptions discussed above.

BEAT computation

The tax liability increase is determined through a multi-step formula used to derive the base erosion minimum tax amount. This amount equals the excess of 10% of the taxpayer's modified taxable income (MTI) for the year (5% for 2018), over an amount equal to the pre-credit regular income tax liability reduced (but not below zero) by any credits, other than the research credit and a certain amount of "applicable section 38 credits" that include the low-income housing credit, renewable energy production credit, and energy credits allowed in that year. Applicable section 38 credits are only included to the extent of 80% of the lesser of the credits or the base erosion tax amount otherwise computed.

MTI is the taxpayer's taxable income, with the base erosion tax benefit amount (including the base erosion percentage of an NOL deduction) added back

The BEAT computation is modified to raise additional revenue for tax years beginning after December 31, 2025 through the following changes which take effect in such years: (i) the 10% of MTI input will increase to 12.5% of MTI; and (ii) the tax liability against which 12.5% of MTI is compared is simply regular income tax liability minus all credits, which appears to remove the previously retained benefit of the research credit and qualifying section 38 credits.

Banks and registered securities dealers are subject to a one percentage point higher BEAT rate in every year: 6% for 2018, 11% for 2019-2025, and 13.5% thereafter.

KPMG observation

The BEAT formula allows taxpayers to retain, at least initially, the benefit of the research credit and some benefit for the three categories of applicable section 38 credits. The latter category appears responsive to reports that the BEAT could have disrupted financing of development in certain markets, such as renewable energy and low-cost housing, which depend on the availability of such credits to attract investors. The following example may help illustrate the formula's application using the 10% BEAT rate.

Assume the ABC U.S. Consolidated Group (ABC) has pre-credit regular tax liability of \$21,000 (corresponding to \$100,000 of taxable income after the 21% corporate income tax rate takes effect). ABC claims \$5,000 of tax credits overall, of which \$2,000 constitute research credits and \$1,000 are applicable section 38 credits. Thus, the "floor" that the BEAT must cross is $\$21,000 - (\$5,000 - \$2,800 (\$2,000 \text{ plus } 0.8 * \$1,000)) = \$18,800$. For companies that are taxpayers, this formula thus effectively adds back the research credit [\$2,000] and 80% of the [\$1,000] of applicable section 38 credits to the otherwise final tax liability [\$16,000].

The BEAT would be owed to the extent that ABC's MTI equaled more than \$188,000 (that is, $\$18,800 \times 10$, or $/0.1$). Stated differently, ABC would have to deduct more than \$88,000 of base erosion tax benefits for the year to be subject to the BEAT.

KPMG observation

The BEAT is a significant new provision and revenue raiser among the new law's international provisions. It will operate in tandem with the new interest deduction limitations, and the disallowance for payments involving hybrid transactions and hybrid entities, to significantly curtail the tax benefit of deductible payments made by U.S. groups to their foreign affiliates. The provision is partially phased in through the lower tax rate in 2018 and then will ramp up in post-2025 years. The JCT scoring line for the provision commensurately projects that nearly a third of the projected revenue will arise in 2026 and 2027.

The provision's status under the United States' income tax treaties and trade agreements has already been questioned by U.S. trading partners in news reports. In particular, the BEAT raises issues regarding the nondiscrimination clauses contained in most U.S. tax treaties. For example, Paragraph 24(4) of the U.S. Model Tax Treaty is implicated because the provision effectively denies a portion of the deductions for payments made to foreign entities where payments made to similarly-situated domestic entities remain fully deductible. While the conference report does not include any statement indicating whether Congress specifically intended to override tax treaties in this regard, the scope of the BEAT would be significantly reduced if it were to be made subject to existing tax treaties, which would be hard to reconcile with the sizable revenue estimate by the JCT. As a general matter, legislation and treaties are on equal footing for U.S. purposes, with the result that the later in time prevails in case of clear conflict, suggesting that the new law would be likely to apply even if it would result in overriding existing tax treaties.

Reporting and penalties

The new law introduces new reporting requirements under the Code section 6038A regime (Form 5472) to collect information regarding applicable taxpayers' base erosion payments. The provision also increases that reporting regime's \$10,000 penalty to \$25,000.

The provision applies to payments paid or accrued in tax years beginning after December 31, 2017. It is estimated to increase revenues by approximately \$149.6 billion over 10 years.



Other provisions

Modify insurance exception to the passive foreign investment company rules

The new law modifies a pre-enactment law exception from passive income that prevents certain investment income derived from the active conduct of an insurance business from causing a foreign corporation to be a passive foreign investment company (PFIC). Section 14501 of the new law amends this exception in the PFIC rules to apply only to a foreign corporation whose applicable insurance liabilities constitute more than 25% of its total assets as reported on the corporation's applicable financial statement for the last year ending with or within the tax year. Applicable liabilities of any property and casualty or life insurance business include loss and loss adjustment expenses and certain reserves, but do not include unearned premium reserves.

An applicable financial statement is a statement for financial reporting purposes that is made on the basis of generally accepted accounting principles (GAAP), on the basis of international financial reporting standards (IFRS) if no GAAP statement is available, or, "except as otherwise provided by the Secretary in regulations," on the basis of the annual statement required to be filed with the applicable insurance regulatory body, but only if neither a GAAP nor IFRS statement is available. Unless otherwise provided in regulations, GAAP means U.S. GAAP.

Section 14501 of the new law provides potential relief to a foreign corporation that cannot meet the new 25% test by giving the Secretary regulatory authority to allow a U.S. person owning stock of such a foreign corporation to elect to treat it as a qualifying insurance company if (1) its applicable liabilities equal at least 10% of its assets, and (2) (a) the foreign corporation is predominantly engaged in an insurance business, and (b) the failure to satisfy the greater than 25% threshold is due solely to runoff-related or rating-related circumstances involving such insurance business.

Section 14501 of the new law applies to tax years (presumably of foreign corporations being tested for PFIC status) beginning after December 31, 2017.

The JCT has estimated that this provision also will increase revenues by approximately \$1.1 billion over 10 years.

The text of this provision of the new law is materially the same as section 14501 of the Senate bill and section 4501 of the House bill, and has the same effective date and revenue effect.

Repeal fair market value method of interest expense apportionment

The new law requires taxpayers to allocate and apportion interest expense of members of an affiliated group using the adjusted basis of assets and prohibits the use of the fair market value method.

According to the JCT, this provision will increase revenues by approximately \$600 million over 10 years.

This provision is effective for tax years beginning after 2017.

Modify Code section 4985 excise tax

The new law increases the section 4985 excise tax rate from 15% to 20%. This tax is imposed on certain stock-based compensation of corporate “insiders” when a domestic corporation becomes an “expatriated corporation” through an inversion transaction in which a shareholder of the domestic corporation recognizes gain.

The provision is effective upon date of enactment. The JCT has estimated that this provision will increase revenues by approximately \$100 million over 10 years.

KPMG observation

This provision largely tracks prior legislative proposals that were described as addressing a perceived abuse whereby some insurance activities were used to shelter large investments. The change may also have an impact on non-U.S. insurance companies that insure long-tail and catastrophic risks.

U.S. persons owning stock of a corporation treated as a PFIC because it is ineligible for the active insurance exception in Code section 1297(b)(2)(B) would be required to begin filing Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, and to consider available PFIC-related elections.

Under Code section 6501(c)(8), a U.S. person that fails to file Form 8621 for a year generally would have the statute of limitations for its tax return for that year kept open until three years after the U.S. person furnishes the required information to the IRS.

Section 14501 of the new law also could require the Department of the Treasury to issue new regulations, and the IRS to amend Form 8621, for taxpayers to take advantage of the election it provides to U.S. shareholders of certain affected foreign corporations that fail the new 25% test.

KPMG observation

Taxpayers that use the fair market value method to value assets when allocating interest expense are required to switch to the adjusted basis or “tax book value” method. Such a switch could have a dramatic effect on the foreign source income calculation for certain taxpayers.



Procedural provisions

Various provisions in the new law impose new compliance requirements. However, the new law did not include many changes directly to the procedural sections of the Code.

See Appendix D for a list of new and revised procedural items.



Extension of time limit for contesting IRS levy

The new law extends the time period from nine months to two years for returning the monetary proceeds from the sale of property that the IRS has wrongfully levied. The new law also extends from nine months to two years the period for bringing civil suit for wrongful levy. See Appendix D for a list of new and revised procedural items.

The provision is effective with respect to (1) levies made after the date of enactment; and (2) levies made on or before the date of enactment provided that the nine-month period has not expired as of the date of enactment.

The JCT has estimated that this provision will lose less than \$50 million over a 10-year period.

KPMG observation

This provision was based on the Senate bill and was adopted without modification. The following procedural provisions that were in the Senate bill were not included in the new law:

- Modifications to the user fee requirements for installment agreements authorized under Code section 6159
- New above-the-line deduction for attorney fees and courts costs to whistleblowers under a broader category of laws
- Amendment to Code section 7623(b) broadening the scope of collected proceeds eligible for awards to whistle-blowers



CRAFT beverages

KPMG observation

The new law follows the Senate bill, without modifications.

The new law makes numerous temporary changes to the taxes imposed on beer, wine, and distilled spirits. The JCT has estimated that these provisions will decrease revenues by approximately \$4.2 billion over 10 years. These provisions will sunset after 2019.



Exempt the aging period of beer, wine and spirits from UNICAP rules related to interest

The Uniform Capitalization (UNICAP) rules under section 263A require certain direct and indirect costs allocable to real or tangible personal property produced (or acquired for resale) to be included in inventory or capitalized into the basis of the related property. In the case of interest expense, the UNICAP rules apply only to interest paid or incurred during the property's production period, and that is allocable to property which either 1) is real property or property with a class life of at least 20 years, 2) has an estimated production period exceeding two years, or 3) has an estimated production period exceed one year and a cost exceeding \$1,000,000.

In the case of property that is customarily aged (e.g., tobacco, wine, and whiskey) before it is sold, the production period includes the aging period. The new law excludes the aging periods for beer, wine, and distilled spirits from the production period for purposes of the UNICAP interest capitalization rules. Thus, under the provision, producers of beer, wine, and distilled spirits could deduct interest expense (subject to any other applicable limitation) attributable to a shorter production period.

This provision is effective for interest costs paid or incurred after December 31, 2017 and will sunset for interest costs paid or accrued after December 31, 2019.

KPMG observation

The new law provides a two-year reduced rate of tax for both small and large brewers and allows foreign brewers to assign such credit to importers if conditions are met.



Reduced rate of excise tax on beer

Section 13802 of the new law amends section 5051 to reduce the amount of federal excise tax imposed on brewers and importers of beer. The new law reduces the tax on beer from \$18 per barrel to \$16 per barrel on the first six million barrels brewed by the brewer or imported by the importer. Beer brewed or imported in excess of the six million barrels is taxed at \$18 per barrel.

For small brewers producing less than 2 million barrels of beer, tax is reduced from \$7 per barrel to \$3.50 per barrel for the first 60,000 barrels. The additional barrels are taxed at \$16 per barrel.

Special rules apply for determining controlled groups and allocation of the reduced tax rates among members of the controlled group. Moreover, the new law provides that two or more entities (whether or not under common control) that produce beer under a similar brand, license, franchise, or other arrangement are to be treated as a single taxpayer for the reduced rates.

Moreover, the conference report for the new law discusses additional rules related to foreign brewers and the assignment of the reduced rate of tax to importers of foreign brewed beer.

This provision applies to beer removed after December 31, 2017 and expires for tax years beginning after December 31, 2019.

KPMG observation

The new law allows more types of tax-free transfers of beer under bond between breweries for a two-year period, essentially providing for a deferral of tax due if conditions are met. Most importantly, it allows for a transfer under bond of beer between unrelated proprietors.



Transfers of beer in bond

Section 13803 of the new law amends section 5414 to allow for more situations in which beer may be transferred tax free under bond by modifying the rules of section 5414. Under the provision, brewers would be able to transfer beer from one brewery to another under any of the following situations:

- The breweries are owned by the same person (pre-enactment law)
- One brewery owns a controlling interest in the other (new)
- The same person or persons have a controlling interest in both breweries (new)
- The proprietors of the transferring and receiving premises are independent of each other, and the transferor has divested itself of all interest in the beer so transferred, and the transferee has accepted responsibility for payment of tax (new)

This provision applies to calendar quarters beginning after December 31, 2017 and expires for tax years beginning after December 31, 2019.



Reduced rate of tax on certain wine

Section 13804 of the new law modifies the section 5041(c) credit for small domestic producers of wine. The new law allows the credit to be claimed by foreign and domestic producers of wine, regardless of the gallons of wine produced. The new law also allows the credit for sparkling wine producers.

Under the new law, the credit for wine produced in, or imported into, the United States during the calendar year is:

- \$1.00 per wine gallon for the first 30,000 wine gallons of wine; plus
- \$0.90 per wine gallon for the next 100,000 wine gallons of wine; plus
- \$0.535 per wine gallon on the next 620,000 wine gallons of wine.

The new law also provides special credit rates for hard cider, as well as rules for allowing foreign producers of wine to assign the credit to importers of the wine.

The provision applies to wine removed after December 31, 2017 and expires for tax years beginning after December 31, 2019.



Adjust alcohol content level of wine for application of excise taxes

Section 13805 of the new law amends section 5041 to modify the alcohol-by-volume levels of the first two tiers of federal excise tax on wine. Generally, under section 5041 before amendment, wine with an alcohol content of not more than 14% alcohol was taxed at a rate of \$1.07 per wine gallon and wine more than 14% but not more than 21% alcohol was taxed at a rate of \$1.57 per gallon. The new law changes section 5041 such that wine with an alcohol content of not more than 16% alcohol is taxed at the \$1.07 per wine gallon rate.

This provision applies to wine removed after December 31, 2017 and expires for tax years beginning after December 31, 2019.

KPMG observation

The new law essentially provides a two-year rate reduction for all foreign and domestic producers of wine, including sparkling wine, regardless of the number of wine gallons produced. Moreover, it allows foreign producers to assign such credit to importers if conditions are met.

KPMG observation

The new law provides a two-year, \$0.50 per wine gallon rate reduction for still wines with an alcohol content of more than 14% but less than 16% alcohol.

KPMG observation

The new law provides a two-year significant rate reduction for mead and certain sparkling wines that contain an alcohol content of less than 8.5% alcohol-by-volume.

Reduced rate of tax on mead and certain carbonated wines

Section 13806 of the new law amends section 5041 to reduce the rate of tax for mead and certain sparkling wine. Under pre-enactment law, sparkling wines were generally taxed at a rate of \$3.40 per wine gallon and artificially carbonated wines were taxed at a rate of \$3.30 per wine gallon. Under the new law, mead and certain sparkling wine are taxed at the lowest rate applicable to “still wine” which is currently a rate of \$1.07 per wine gallon of wine.

“Mead” is defined as a wine that contains not more than 0.64 grams of carbon dioxide per hundred milliliters of wine, which is derived solely from honey and water, contains no fruit product or fruit flavoring, and contains less than 8.5% alcohol-by-volume.

The sparkling wines eligible to be taxed at the preferential rate are wines that contain no more than 0.64 grams of carbon dioxide per hundred milliliters of wine, which are derived primarily from grapes or grape juice concentrate and water, which contain no fruit flavoring other than grape and which contain less than 8.5% alcohol-by-volume.

This provision applies to wine removed after December 31, 2017 and expires for tax years beginning after December 31, 2019.

KPMG observation

The new law provides a two-year significant rate reduction for distilled spirit producers and importers.



Reduced excise tax rates on distilled spirits

Under pre-enactment Code section 5001, all distilled spirits were taxed at a rate of \$13.50 per proof gallon. Section 13807 of the new law institutes a tiered rate for distilled spirits. The new law amends section 5001 to tax the first 100,000 proof gallons of distilled spirits at a rate of \$2.70 per proof gallon. The tax rate for proof gallons greater than 100,000 but less than 22,130,000 proof gallons is \$13.34 per proof gallon, and the rate for 22,130,000 proof gallons or more is \$13.50 per proof gallon.

Special rules apply for determining controlled groups and allocation of the reduced tax rates among members of the controlled group. Moreover, the new law provides that two or more entities (whether or not under common control) that produce distilled spirits under a similar brand, license, franchise, or other arrangement are to be treated as a single taxpayer for the reduced rates.

Moreover, the conference report for the new law discusses additional rules related to foreign producers and the assignment of the reduced rate of tax to importers of foreign produced spirits.

This provision applies to distilled spirits removed after December 31, 2017 and expires for tax years beginning after December 31, 2019.



Allow transfer of bonded spirits in bottles

Section 13808 of the new law amends section 5212 to expand allowable tax-free transfers in bond of distilled spirits to distilled spirits that are not packaged in bulk containers.

Generally, tax is imposed on distilled spirits upon removal from the distilled spirits plant. Under pre-enactment law, bulk distilled spirits could be transferred without payment of tax if the transfer were under bond between bonded premises and in containers that are at least one gallon; that is, a bulk container.

This provision applies to distilled spirits removed after December 31, 2017 and expires for tax years beginning after December 31, 2019.

KPMG
observation

The new law allows transfers of distilled spirits in bottles to be made tax-free under bond for two years.



REITs

The new law provides a deduction to noncorporate taxpayers (individuals, trusts, and estates) of 20% on dividends paid by a REIT that are neither capital gain dividends nor are eligible for treatment as “qualified dividend income.” This provides parity between the treatment under the new law of ordinary REIT dividends and “qualified business income” (setting aside the wage/capital limitation, which would not apply to limit the deduction applicable to ordinary REIT dividends). The new law also provides for a maximum individual marginal tax rate on ordinary income, without regard to the effect of this deduction, of 37%. For noncorporate taxpayers, this would reduce the maximum marginal tax rate on ordinary REIT dividends to 33.4% (including the 3.8% Medicare tax, which is seemingly applied before application of the 20% deduction).

The new law reduces the effective tax rate on dividends paid by a domestic C corporation to noncorporate domestic taxpayers to approximately 39.8%, including 21% at the corporate level. As indicated above, the effective tax rate under the new law on ordinary dividends paid by REITs to individual taxpayers would appear to decrease from 43.4% to approximately 33.4%. This is a smaller disparity than under pre-enactment law. Under the new law, the disparity in tax rate for these taxpayers for distributions attributable to net capital gain generally would be approximately 16% (approximately 39.8% for C corporations, and 23.8% for REITs).

A noncorporate taxpayer invested in or considering investments in partnerships the equity of which is linked to the share value of a REIT (i.e., UPREIT and DownREIT partnerships) should consider that, through 2025, it may be subject to a higher rate of tax on ordinary income allocated to it by the partnership than would be the case if the investor were to receive the same income via a dividend from the REIT, given that the wage/capital limitation on the 20%-deduction does not apply to REIT dividends. That the deduction is limited either by a wage factor or by a combination of wage factor and a capital factor, as opposed to merely a wage factor, may be effective in reducing or eliminating this disparity, depending upon the circumstances.

Importantly, the new law's reduction in corporate tax rate applies to tax years beginning after 2017, and is permanent. Both the 20% deduction and the new rate structure for noncorporate taxpayers (which, among other things, would reduce the maximum income tax rate to them from 39.6% to 37%, not taking into account the 3.8% Medicare tax) are scheduled to sunset for tax years beginning after 2025. Under the new law, therefore, for tax years beginning after 2025, absent further legislation, the effective tax rate for ordinary dividend income of individual taxpayers from C corporations would remain approximately 39%, while the effective tax rate for dividend income of noncorporate taxpayers from REITs would increase to 43.4%; the effective rates for capital gain income generally would not change as a result of the sunset.

Foreign income

As described elsewhere, the changes made by the new law to the taxation of U.S. taxpayers' foreign income are substantial, and would have an effect on REITs that invest overseas. Domestic corporate taxpayers generally would be able to fully deduct the "foreign-source portion" of dividends from foreign corporations (other than certain passive foreign investment corporations) in which they are "United States shareholders" (i.e., they hold a 10%-or-greater voting interest, determined taking into account applicable attribution rules). REITs would be ineligible for this deduction. While those dividends also would seem to continue to be qualifying income for purposes of the 95% gross income test applicable to REITs, under the new law they also would be taken into account in calculating a REIT's taxable income and, therefore, its distribution requirement.

As a transition to a territorial system which incorporates the dividends-received deduction for foreign-corporate dividends described above, the new law includes provisions treating certain accumulated earnings of certain foreign corporations as being repatriated; a portion of the amount is deductible, generally so as to result in a specific rate of tax (with a higher rate applying where the deferred earnings are treated as held as cash assets). REITs generally would be entitled to this deduction. The new law treats the accumulated deferred foreign income that would be treated as repatriated in the last tax year of such foreign corporation that begins before January 1, 2018 as (or as if it were) Subpart F income. The new law, following the Senate bill, explicitly disregards the repatriation inclusions for REIT gross income test purposes. Under pre-enactment law, Subpart F income is not explicitly treated as qualifying income for either gross income test, though the IRS has issued a number of private letter rulings concluding, under its authority provided in section 856(c)(5)(J), that the specific Subpart F income earned by the REIT and described in the ruling would be treated as qualifying income for purposes of the 95% gross income test (though not the 75% gross income test). The approach included in the new law allows REITs to avoid this uncertainty.

Moreover, the new law, again following the Senate bill, permits REITs to elect to satisfy their distribution requirement with respect to the repatriation inclusion over an eight-year period, using the same installment percentages that apply to other U.S. taxpayers,

and generally eligible for the partial dividends-received deduction described above. This takes the form of the relevant installment being included in the REIT's "REIT taxable income" for the relevant year subject to acceleration in connection with certain events (e.g., a liquidation or sale of substantially all of REIT's assets).

Other Important Items

Several other points are worth mentioning.

First, REITs would in many cases (or with respect to large portions of their businesses) appear to be able to elect out of the new limitation on the deductibility of net business interest expense that exceeds 30% of the REIT's "adjusted taxable income." This is because many REITs (and partnerships in which they invest) are engaged in "real property trades or businesses" within the meaning of the passive-activity loss rules; those businesses are not covered by this new limitation if the taxpayer so elects. Mortgage REITs presumably are more likely to be subject to such a limitation, though the overall effect of the limitation on a mortgage REIT might not be significant given that the limitation applies to net business interest expense, and mortgage REITs typically expect to have substantial interest income. The breadth of the definition of a "real property trade or business" might, though, allow REITs investing in "nontraditional" REIT asset-classes to avoid this limitation. For purposes of the new law, a "real property trade or business" is defined by reference to the passive-loss rules and includes "any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business." The explanation by the Senate Finance Committee of its bill, which is reproduced in the conference report's explanatory statement, indicates that the definition of a "real property trade or business" is intended to be interpreted to include the operation or management of a lodging facility. Further, while not entirely clear and presumably dependent on the specific nature of a given business, this definition might be sufficiently broad to cover certain businesses that have been treated for REIT purposes as involving the rental of real property, such as the operation by a REIT of data centers.

For those REITs (or REIT-owned partnerships) that would be subject to the limitation, this calculation generally is determined at the partnership-level

rather than the partner-level, though the partner's share of the partnership's "excess limitation" (i.e., the amount by which the partner's share of 30% of the partnership's "adjusted taxable income" exceeds the partnership's net business interest expense) can be used by the partner to absorb its directly incurred net business interest expense. Disallowed interest expense could be carried to future tax years indefinitely.

In computing the taxpayer's "adjusted taxable income," the new law excludes deductions for depreciation, amortization, and depletion, but only for tax years beginning before 2022. For tax years beginning after 2021, depreciation, amortization and depletion would be taken into account in determining adjusted taxable income, resulting in a potentially more restrictive net interest limitation. For a REIT engaged in a "real property trade or business," the amount of its cost recovery deductions would presumably influence its decision to elect out of this net interest limitation. Such election, once made, would be irrevocable.

This provision applies to tax years beginning after 2017, and replaces the earnings-stripping rules under Code section 163(j).

The new law includes other provisions intended to combat "base erosion." Specifically, the new law imposes a tax generally equal to the amount by which a specified percentage (5% for tax years beginning in 2018), 10% for tax years beginning after 2018 and before 2026, and 12.5% for tax years after 2025) of the "modified taxable income" of an "applicable taxpayer" for a year exceeds its "regular tax liability" (reduced by certain credits) for the year. Modified taxable income is determined by excluding tax benefits associated with certain payments made to foreign affiliates. The new law exempts certain payments to the extent that they are subject to FDAP withholding; to the extent that FDAP withholding on the payment is less than 30%, only a corresponding portion of the payment is exempt. The purpose of this rule is to limit "base erosion" resulting from payments by U.S. (and certain foreign) corporations to foreign affiliates that are not subject to an appropriate level of U.S. federal income tax. Importantly, though, REITs themselves would not seem to be affected—the definition of "applicable taxpayer" excludes REITs.

Second, taxpayers electing out of the interest limitations under new section 163(j) would be required to use the alternative depreciation system (ADS). The new law, however, reduces the ADS recovery period for residential real property from 40 years to 30 years. The MACRS periods for nonresidential and residential real property under pre-enactment law would not be modified by the new law; the new law provides a 15-year MACRS period for qualified improvement property.

The new law allows for immediate expensing, on temporary basis, of certain types of business assets placed in service after September 27, 2017, including property to which MACRS applies with an applicable recovery period of 20 years or less, including qualified improvement property. REITs do not appear to be generally ineligible for these benefits.

Third, the new law limits the utilization of NOL carryovers to 80% for NOLs arising after 2017. For purposes of these limitations, a REIT's taxable income would be the REIT's "REIT taxable income" without taking into account the dividends paid deduction (DPD). Given that a REIT ordinarily determines its utilization of NOL carryovers after its DPD, this is necessary to avoid causing a REIT to fail the minimum distribution requirement, incurring a corporate-level tax, or forgoing the utilization of NOL carryovers. Furthermore, the new rules seemingly would mean that a REIT could use an NOL carryover to offset all of its REIT taxable income after paying distributions to its shareholders, provided that the REIT distributed at least 20% of pre-DPD REIT taxable income.

The new law repeals the corporate AMT effective for tax years beginning after 2017; under pre-enactment law, 10% of the amount offset by the utilization of an NOL carryover as an AMT preference item.

Fourth, the new law would appear to keep the provisions relating to foreign investment in real property largely intact, beyond reducing the corporate income tax rate applicable to foreign corporations' effectively connected income (including, generally speaking, their income subject to FIRPTA). There had been some public speculation as to whether the rules under FIRPTA might be relaxed or even repealed entirely so as to incentivize foreign investment in U.S. real estate and infrastructure assets.

Lastly, the new law eliminates tax-free like-kind exchanges for all property other than real property not held primarily for sale, effective for exchanges completed after 2017. REITs often use like-kind exchanges to defer gain while disposing of their real property holdings





The new law might have significant consequences for RICs, including business development companies (BDCs), from potentially limiting RIC expenses to accelerating RIC income from investments. In addition, global asset managers of RICs might be significantly affected by the international tax reform provisions.

Potential acceleration of RIC income and gain

The new law revises certain rules associated with the recognition of income by requiring that taxpayers recognize income no later than the tax year in which such income is taken into account on an applicable financial statement. Certain fees that are treated as original issue discount (OID) on a debt instrument may be required to be included in income for financial statement purposes when received, whereas they are accrued into income over the term of the debt instrument under pre-enactment law. These fees would be accelerated into income upon receipt. While this change would have relevance to all RICs, it could have especially significant consequences to RICs that are BDCs due to the substantial debt holdings of many BDCs, much of which is originated by such BDCs and involves payments of upfront fees. The accelerated inclusion of OID applies to tax years beginning after December 31, 2018.

As noted in the KPMG observations above, whether the provision requires certain taxpayers to accelerate the accrual and recognition of market discount is unclear. Sponsors of municipal bond funds should consider the impact on their required fund disclosures and shareholder distributions of realizing market discount treated as ordinary income. This accelerated inclusion and recognition of market discount, if applicable, would apply for tax years beginning after December 31, 2017.

Specific provisions for REITs (but not RICs)

- The deduction of 20% for certain passthrough income treated as qualified business income would specifically treat dividends from a REIT (other than any portion that is a capital gain dividend or qualified dividend income) and certain income from publicly traded partnerships as qualified business income. However, the new law would not extend similar treatment to ordinary dividends paid by RICs. This change could create an “unlevel” playing field for RIC investors in two key respects. First, for RICs investing in REITs, RIC dividends are not provided comparable treatment to the extent such dividends are attributable to REIT distributions treated as qualified business income. Second, although BDCs may be taxed like other RICs, they historically have been taxed similarly to other types of passthrough entities,

such as REITs, MLPs, and publicly traded partnerships, which also may engage in activities other than investment in securities. By definition, a BDC electing to be treated as such under the Investment Company Act of 1940 is required to make available “significant managerial assistance” to certain of the portfolio companies in which the BDC invests. The BDC industry sought (albeit unsuccessfully) to expand qualified business income to include “qualified BDC dividends.”¹³

- The new law also includes specific provisions for REITs subject to mandatory repatriation of foreign earnings. Comparable treatment is not provided for RICs subject to mandatory repatriation inclusions, including with respect to the determination of a RIC’s gross income and distribution requirements.

Municipal lending

RICs that invest in advance refunding bonds should be aware that the new law repeals the exclusion from gross income for interest on such bonds issued after December 31, 2017. The new law also repeals the authority to issue tax credit bonds and direct pay bonds after December 31, 2017.

Reduction in dividends received deduction percentages

For tax years beginning after December 31, 2017, the new law reduces the 80% dividends received deduction to 65% and the 70% dividends received deduction to 50% to preserve the pre-enactment law effective tax rates on income from such dividends. Corporate shareholders in a RIC could be affected by this change as a RIC is permitted to treat its dividends as qualifying for the dividends received deduction.

Limitation of deductions for net business interest

As drafted, it appears that RICs could be subject to the new limitation on the deductibility of net business interest like other corporations. However, the RIC industry might seek clarification of whether RICs have a “trade or business” for this purpose, such that RICs would be subject to the provision.

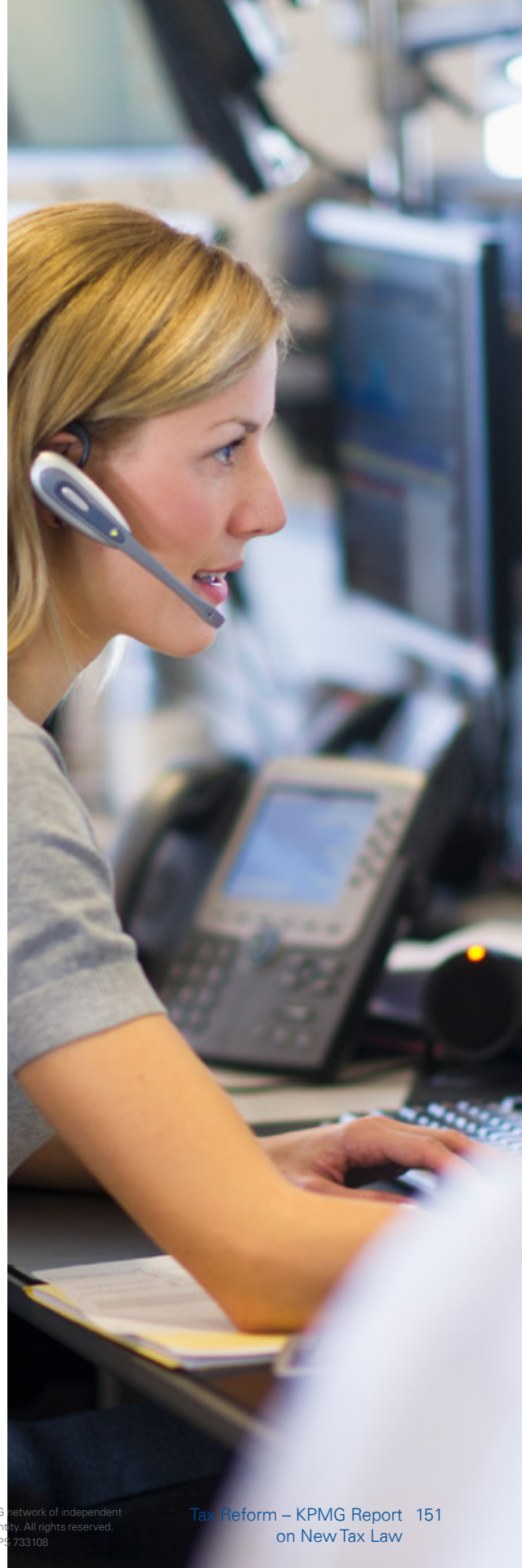
Under the new law, the amount allowed as a deduction for business interest cannot exceed the sum of a taxpayer’s business interest income, 30% of the taxpayer’s adjusted taxable income, and the taxpayer’s floor plan financing interest. Business interest expense is defined as interest paid or accrued on indebtedness properly allocable to a trade or business. Business interest does not include investment interest within the meaning of Code section 163(d). The explanatory statement in the conference report states in a footnote that “Section 163(d) applies in the case of a taxpayer other than a corporation. Thus, a corporation has neither investment interest nor investment income within the meaning of Section 163(d). Thus, interest income and interest expense of a corporation is properly allocable to a trade or business, unless such trade or business is otherwise explicitly excluded from the application of the provision.”

¹³See proposed Senate amendment number 1829 introduced by Senator Jim Risch (R-ID); <https://www.congress.gov/amendment/115th-congress/senate-amendment/1829/text>.

While relevant for all RICs, limiting the deductibility of net business interest expense could be particularly significant for BDCs. BDCs may have material leverage in their portfolios and could have timing differences in the recognition of interest income and interest expense, giving rise to net business interest subject to the limitation. This change applies to tax years beginning after December 31, 2017. For a RIC that is a partner in a partnership, the RIC also should consider the implications of any carryforward of excess business interest from the partnership.

Other relevant provisions

- RICs, REITs and S Corporations are specifically excluded from application of the base erosion minimum tax provisions. Also, the deduction for foreign-derived intangible income and global intangible low-taxed income is available only to C corporations that are not RICs or REITs.
- For a RIC acquiring an interest in a partnership, the RIC should consider the implications of the requirement that the transferee of a partnership interest withhold 10% of the amount realized on the sale or exchange of the interest unless the transferor certifies that it is not a nonresident alien individual or a foreign corporation and provides a U.S. taxpayer identification number.
- A RIC should consider whether the new law's elimination of the constructive ownership rule in section 958(b)(4) could cause the RIC to be treated as a U.S. shareholder in a CFC due to downward attribution of stock owned by a foreign person to a U.S. person.
- The suspension of the ability of individual taxpayers to deduct miscellaneous itemized deductions for tax years beginning after December 31, 2017 and before January 1, 2026, would not affect the ability of publicly offered RICs to deduct expenses under section 67(c)(2). The new law adds a new section 67(g) to the Code which applies to individuals and would not alter the RIC rule.





Natural resources

For natural resources, in general, special rules continue to apply with respect to:

1. oil and gas geological and geophysical costs (section 167(h), qualified tertiary injectant expenses (section 193), intangible drilling costs (section 263(c), as limited for integrated corporations by section 291(b), and section 263(i)), depletion (sections 611, 612 and 613A), ordinary income recapture potential (section 1254);
2. mining exploration and development costs (sections 616 and 617, as limited for corporations by 291(b)), depletion (sections 611, 612 and 613 as limited for corporations by 291(a)(2) for percentage depletion in excess of tax basis on iron ore and coal), the disposal of coal or domestic iron ore with a retained economic interest as capital gain (section 631(c)), and ordinary income recapture potential (section 1254); and
3. timber reimbursements of certain government reforestation costs (section 126(a)(8) and (9)) and amortization of certain reforestation expenditures (section 194), election to consider cutting timber or the disposal of timber with a retained economic interest as a sale (section 631(a) and (b)).

The new law does not repeal either the section 43 enhanced oil recovery credit or the section 45I credit for producing oil and gas from marginal wells for tax years beginning after December 31, 2017. However, section 199 is repealed for tax years beginning after December 31, 2017.

In addition, a new section 199A provides a 20% deduction for qualified business income for certain noncorporate taxpayers (including income from publicly traded partnerships) for tax years beginning after December 31, 2017. For example, a small individual oil and gas working interest owner could qualify for the section 199A deduction, and pay the section 1401 self-employment of 3.8% (deductible for income taxes) instead of the section 1411 3.8% net investment income tax.

The AMT is repealed for corporations for tax years beginning after December 31, 2017. Taxpayers other than corporations continue to be subject to the alternative minimum tax and may need to make adjustments for mine exploration and development costs (section 56(a)(2)(A)); mine depletion (sections 56(g)(F)(i) and 57(a)(1)); and the oil and gas and geothermal intangible drilling and development costs preference (section 57(a)(2)). Section 59(f) (which coordinates section 59(e) with a corporate section 291) is being repealed. It appears that Congress did not expect corporations to use 59(e)

after 2017. A corporation with domestic NOLs and foreign source income covered by foreign tax credits may want to consider using section 59(e) to eliminate the domestic NOL.

Mineral streaming agreements (advance sale of future severed minerals, i.e., personal property) are subject to the new law's amendment to section 451, requiring an accrual method taxpayer receiving an advance payment 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 is recognized in an applicable income statement, or another financial statement under the rules specified by the Secretary, but with an exception requiring the remaining portion of the advance payment to be included in income in the tax year following the tax year in which the payment is received. However, the language of this provision seems to equate gross receipts with gross income (i.e., gross receipts minus cost of goods sold). The new law's amendment to section 451 does not apply to production payments (transfer of minerals in the ground, i.e., real property) subject to section 636.

Under the new law, section 1031 like-kind exchanges are limited to real property for tax years beginning after December 31, 2017. Mineral interests and standing timber are real property and ought to continue to qualify as like kind exchanges (e.g., unitizations and poolings). Also, certain permanent structures may be treated as real property, for example, offshore production platforms. Personal depreciable property in a like-kind exchange may generate a taxable event but may also qualify for 100% expense treatment under section 168(k).





State and local tax implications

Background

Nearly every state corporate and personal income tax conforms in some manner to the federal Code. Conformity between state and federal taxes simplifies compliance for taxpayers, and at the same time, reduces the administrative burden facing state tax authorities.

States follow two patterns in conforming to the federal income tax. Rolling or current conformity states tie the state tax to the Code for the tax year in question, meaning they adopt all changes to the Code as passed by Congress unless the state passes legislation to decouple from specific provisions. Static or fixed-date conformity states tie to the Code as of a particular date (e.g., December 31, 2016), meaning the state legislature must act to incorporate subsequent federal changes into the state tax code. States are about evenly divided between rolling and static conformity. A small number of states, notably California, adopt selected Code provisions, rather than using the blanket approach used by most states. Static conformity states generally update their conformity annually or at least regularly; California tends to be an exception and is somewhat irregular in its conformity updates for various reasons.

Corporate overview

For corporate income taxes, states generally begin the computation of state corporate taxable income with federal taxable income and therefore allow, for state tax purposes, many federal deductions. A majority of the states start with line 28 of federal Form 1120 (taxable income before net operating losses and special deductions), and the remainder start with line 30, which includes net operating losses and special deductions. States establish their own tax rates and do not, for the most part, conform to various federal tax credits aimed at promoting various types of activities, such as credits for alternative energy sources. The research and development credit is an exception, as a number of states allow a counterpart credit based largely on the contours of the federal credit.

Regardless of whether they use rolling or static conformity, states tend to pick and choose the federal items to which they conform, often choosing not to conform to items that have major revenue loss consequences. For example, many states have decoupled from federal bonus depreciation.

Individual overview

On the individual income tax side, most states conform to the federal definition of adjusted gross income (AGI). Seven states conform to federal taxable income (meaning they incorporate the federal standard deduction and the currently-suspended personal exemption allowance in addition to the AGI provisions). States that allow itemized deductions also usually conform to federal itemized deductions, with the most common model allowing all federal itemized deductions other than the deduction for state income taxes. There are 11 states that do not provide for itemized deductions.

As with the corporate tax, states establish their own tax rates and tend not to conform to a wide range of federal income tax credits. The earned income credit is the most common exception to this general rule. In addition, only a few states have an individual AMT.

Given these relationships between federal and state income taxes, enactment of federal tax changes that affect the computation of the tax base, by altering the income reflected or the deductions allowed, will have an impact on state taxes. Changes to federal tax rates and tax credits would not, for the most part, have a direct impact on state taxes. With this as background, the state tax implications of certain of the changes contained in the new law are reviewed below.

Individual provisions

Tax rates: The new law retains seven individual income tax rate brackets with a maximum rate of 37%, compared to 39.6% under prior law. The maximum is applicable at \$500,000 taxable income for single filers and \$600,000 for those filing joint returns. These rates and most of the individual income tax provisions in the new law expire after December 31, 2025. At that point, the law will revert to the law as in effect before January 1, 2018 (absent legislation extending the new law's rate structure). The revision of tax rates and brackets would not directly affect state taxes as states establish their own individual tax rate structures.

Passthrough deduction: The new law allows an individual taxpayer to deduct 20% of domestic qualified business income from a partnership, S corporation, or sole proprietorship. This deduction, similar to the other provisions affecting individual taxpayers, sunsets after 2025. The deduction generally is limited to the greater of: (a) 50% of the W-2 wages paid with respect to the trade or business; or (b) 25% of the W-2 wages paid with respect to the trade or business plus 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property. The limitation described in the preceding sentence does not apply in the case of a taxpayer with income of \$315,000 or less for married individuals filing jointly (\$157,500 for other individuals), but phases-in over the next \$100,000 of taxable income for married individuals filing jointly (\$50,000 for other individuals). (See discussion above under section dealing with deduction of passthrough business income for further details on computing the deduction.) Qualified income is defined generally to include income arising from the conduct of a trade or business, other than specified service trades or businesses (e.g. health, law, accounting, but specifically excluding engineering and

architecture). There is an exception allowing the 20% deduction in the case of certain taxpayers with income from a specified service business whose taxable income does not exceed \$315,000 for married individuals filing jointly or \$157,500 for other individuals with a phase-out of this benefit over the next \$100,000 of taxable income for married individuals filing jointly (\$50,000 for other individuals).

The passthrough deduction is structured as a new Code section 199A. The new law specifies that the deduction will not be taken into account in computing AGI for individual income tax purposes. Instead, it will be treated as a deduction from taxable income. However, the deduction is available both to taxpayers that itemize their deductions and those that do not. As such, the impact at the state level depends on the manner in which a state conforms to itemized deductions. As noted, most states currently conform to federal itemized deductions with the exception of the deduction for state income taxes paid. There are 11 states that do not allow itemized deductions. The impact of the passthrough deduction on states could be substantial. The JCT has estimated that the federal revenue impact of the provision is about \$415 billion over the eight years it will be in place.

Standard deduction, personal exemption allowance, and child credit: The provisions in the new law effectively double the standard deduction for all tax filers, repeal the personal exemption allowances, and enhance the child tax credit. These changes are scheduled to sunset at the end of 2025. These changes would not automatically affect most state personal income taxes as the large majority of states with an individual income tax conform to AGI, which is computed before these factors come into play. There are, however, seven states that conform to the federal definition of taxable income for individual income tax purposes, meaning the changes in the standard deduction and repeal of personal exemptions would be incorporated into the state individual income tax, presuming continued conformity. There are five additional states that have adopted the federal standard deduction levels. There are 10 states that do not utilize a standard deduction in their personal income tax.

Itemized deductions: The new law repeals or revises many federal itemized deductions, including deductions for state and local property, income and sales taxes, personal casualty losses,

mortgage interest, and a variety of miscellaneous deductions. Specifically, the changes to itemized deductions contained in the new law (all of which apply to tax years beginning after December 31, 2017 and before January 1, 2026 unless otherwise noted) include:

- The deduction for mortgage interest is limited to the interest on \$750,000 of acquisition indebtedness for debt incurred after December 15, 2017. The limit on deducting interest on acquisition indebtedness for debt incurred prior to December 15, 2017 remains at \$1,000,000. The new law repeals the deduction related to interest incurred on home equity debt.
- In the case of an individual, the new law limits the deduction for state, local and foreign property taxes and state and local sales taxes, as a general matter, only to such taxes when they are paid or accrued in carrying on a trade or business. State and local income taxes, war profits taxes and excess profits taxes are not allowed as a deduction for an individual taxpayer. The new law contains an exception to this general rule allowing an individual taxpayer to claim an itemized deduction of up to \$10,000 (in the aggregate) for state and local property taxes not incurred in carrying on a trade or business and state and local income, war profits and excess profits taxes (or sales taxes in lieu of income taxes). Foreign real property taxes would not be deductible under the exception.
- The personal casualty loss deduction is retained in the new law, but only for losses incurred in a federally declared disaster area.
- The new law provides an itemized deduction for unreimbursed medical expenses in excess of 7.5% of AGI for tax years 2017 and 2018.
- Miscellaneous itemized deductions subject to the 2% of AGI floor (e.g., tax preparation expenses, work clothing, hobby expenses, and unreimbursed business expenses) are repealed under the new law.
- The new law also repeals the overall limitation on itemized deductions.

With respect to the deduction of state and local income, property, and sales taxes, the conference report's explanatory statement makes clear that, in the case of an individual, the state and local income taxes imposed on individual owners or partners in the passthrough entity are

not deductible. However, state and local income taxes imposed at the entity level that are reflected in computing the owner's or partner's distributive share of income from the passthrough remain deductible. Also, property taxes and sales and use taxes paid by the passthrough entity remain deductible.

As noted, the large majority of individual income tax states that allow itemized deductions conform to the federal definitions of those deductions, meaning that most of the changes would affect those states. Importantly, however, the largest component of the revenue effect of the itemized deductions appears to be from the repeal of the uncapped state and local tax income deduction, which is not allowed in the vast majority of states that allow itemized deductions. Property taxes are, however, generally allowed as a state itemized deduction. To the extent a state retains itemized deductions not allowed at the federal level, there could be challenges in documentation and compliance.

Repeal of the so-called "individual mandate": Under the new law, the amount of the individual shared responsibility payment enacted as part of the Affordable Care Act is reduced to zero. Repeal of the individual mandate will not directly affect an individual's state tax liability.

Alternative minimum tax: The new law retains the individual AMT with an increased exemption amount for tax years 2018 through 2025. Beginning in tax year 2026, the exemption amount reverts to its former level. A few states impose an AMT. State alternative minimum taxes are generally modeled after the federal tax, but they are not computed as a percentage of federal AMT liability. Therefore, the retention of the federal AMT will have little to no effect for state purposes.

Business provisions

Tax rates: The new corporate tax rate reduction to 21% beginning in 2018 would not have a direct impact on state taxation as states establish their own rate structures. The reduction in federal rates may cause state corporate income taxes to be relatively more important versus the federal tax, and consequently, increased attention may be paid to state tax rates if they remain unchanged. Due to the lower federal rate, the federal 80% dividends received deduction is reduced to 65% and the federal 70% dividends received deduction is reduced to 50%. These federal changes will potentially affect the state tax base in those states that conform to the federal dividends-received deduction amounts.

Expensing certain assets: The new law increases the 50% bonus depreciation regime under Code section 168(k) to 100% expensing for qualified assets placed in service after September 27, 2017 and before December 31, 2022. For assets placed in service after that date, the amount of expensing allowed declines by 20 percentage points each year, until it phased out for property placed in service after December 31, 2026. In terms of property qualifying for the 100% expensing, the new law continues to apply the expensing to most assets that are covered by bonus depreciation and expands that coverage to include used assets that are acquired by a taxpayer for the first time. The expensing provisions of the new law do not

apply to certain property of regulated utilities or to property financed by floor financing indebtedness. The new law also increases the availability of expensing for certain small businesses under Code section 179. The increased expensing allowance will flow through to the state tax base in rolling conformity states unless the state acts to decouple or has already decoupled from bonus depreciation. There will be no impact in static conformity states unless the state acts to adopt the change.

As noted, most states (about 30) have chosen not to conform to the bonus depreciation regime, largely because of the negative revenue impact. The revenue implications of the new 100% expensing provisions and the enhanced deductions allowed during the phase-out will be substantial both for states that currently conform to bonus depreciation and those that do not currently conform. In other words, certain states that conformed to 50% bonus depreciation may not be able to absorb the cost of immediate expensing. Because the full expensing system is accomplished by amending Code section 168(k), there are likely to be a minimum of compliance-related issues emanating from the change beyond those experienced currently in states that do not conform to bonus depreciation.

Interest deductibility: The new law disallows the deduction of net interest expense (excluding floor plan financing interest) to the extent it exceeds 30% of a taxpayer's adjusted taxable income (ATI), with an exception for taxpayers with an average of \$25 million or less in gross receipts over the three prior years, certain real property businesses, farming businesses, regulated public utilities, and electric cooperatives. Unused amounts could be carried forward indefinitely. ATI is defined in the new law as the taxable income of the taxpayer computed without regard to any business interest or business interest income, the 20% deduction for certain passthrough entities, NOLs, and for tax years beginning before January 1, 2022, any deduction for depreciation, amortization or depletion.

This limitation may flow through to the state tax base if a state conforms to the change. At the federal level, the limit on interest deductibility is generally viewed as a counterpart to the 100% expensing allowed for certain assets (even though it is a permanent change and the 100% expensing starts to phase-out after five years). Whether that policy carries over to states that choose not to conform to the expensing is an open question.

The JCT has estimated that the federal revenue impact of the interest limitation is approximately \$250 billion over 10 years.

If a state chooses to conform to the interest limitation, there will be certain complexities because of the different filing methods at the state and federal level. The federal limitation would be determined at the taxpayer level, which would, in many cases, be the consolidated group. For state purposes, a member of the federal consolidated group may be required to file a separate return or as a member of a unitary combined group. To deal with the different composition of the "taxpayer" at the state level, states often require individual consolidated group members to re-compute federal taxable income as if the member had filed separately, rather than consolidated, at the federal level. In addition, over 20 states currently have rules that disallow the deduction of interest or intangible-related interest paid to related parties. Coordinating the state and federal rules in these states could also present complications. For example, because the federal limit applies to all interest, and money is fungible, it may not be clear whether the character of the interest that is allowed to be deducted is "related party" interest for state purposes.

Net operating loss limitations: The new law restricts the use of net operating losses (NOLs) by taxpayers (other than property and casualty insurance companies). Effective for losses arising in tax years beginning after December 31, 2017, the new law eliminates the NOL carryback provisions in most cases, allows NOLs to be carried forward indefinitely, and limits the amount of NOL deduction used to 80% of the taxpayer's taxable income determined without regard to the deduction. Many states start their computation of state taxable income with Line 28 of the federal form 1120, which is federal taxable income before NOLs and special deductions. Other states that start the computation of taxable income with Line 30 require an addback of the federal NOL and then require computation of a state-specific NOL. There are only a handful of states that directly incorporate the federal NOL. However, a number of states reference Code section 172 in the statutes providing for the state-specific NOL (e.g., stating that the state NOL should be treated in the same manner as for federal purposes). Because the new 80% federal NOL limitation is added to Code section 172, it is unclear how that limitation interacts with those state NOL provisions that reference section 172. States

also vary significantly in their allowance of NOL carryforwards and carrybacks. Most states do not allow a carryback, and there are varying (but always specified) carryforward periods. In addition, several states have their own limitations (e.g., Louisiana and Pennsylvania) on the extent to which NOLs may offset taxable income. States seem likely to continue to choose their own approach to NOLs, resulting in continued complexity.

Repeal of other deductions and modification of certain

credits: The new law repeals or limits certain other business deductions (e.g., certain meals and entertainment expenses, transportation fringe benefits, and expenses for lobbying before local governments). To the extent a state currently conforms to a deduction, limiting or repealing the deduction will broaden the state tax base (assuming continued conformity). One of the most significant deductions that is repealed is the Code section 199 deduction (effective for tax years beginning after December 31, 2017 for C corporations) to which about one-half of the states currently conform. Interestingly, in a fixed-date state that currently allows the section 199 deduction, there would appear to continue to be a state-only section 199 deduction until the state updated its IRC conformity. The new law makes some modifications to existing corporation tax credits, but the modifications would not have a significant impact on state taxes.

Contributions to capital: The new law revives a modified version of a provision that originated in the House bill, but was not in the Senate bill, related to the treatment of grants and contributions to private entities for economic development purposes. The new law amends Code section 118 and requires any contribution in aid of construction or other contribution by a customer or potential customer and any contribution by a governmental entity or civic group (other than a contribution by a shareholder as such) to be included in the income of the receiving entity. In addition, the explanatory statement expresses the conferees' intent that section 118 "continue to apply only to corporations." The explanatory document accompanying the original House bill indicated that the section would affect only grants made by governmental entities and would not affect tax abatements. This is not explicitly noted in the explanation in the conference report. The provision applies to contributions made after the date of enactment unless the contribution is made pursuant to a master development plan approved by the governmental entity prior to the date of enactment. The new law also eliminates the tax exemption for advanced refunding bonds and the authority to issue tax credit bonds. It retains the exemption for qualified private activity bonds, including those issued to finance professional sports stadiums.

Alternative minimum tax: The new law repeals the corporate AMT effective December 31, 2017. Eight states currently have an alternative minimum tax on corporations: Alaska, California, Florida, Iowa, Kentucky, Maine, Minnesota, and New Hampshire. However, the state alternative tax is not computed as a percentage of the federal tax and the repeal of the federal AMT would not affect the states.

International provisions

From the start, one of the stated goals of tax reform was to revise the way multinational businesses are taxed. The new law accomplishes three objectives with respect to the treatment of foreign income and international tax reform: (a) shift the United States from a worldwide system of taxation closer to a system of territorial taxation; (b) transition to the new quasi-territorial system by requiring an immediate repatriation of certain foreign entity earnings and profits that have heretofore been deferred from U.S. taxation; and (c) establish measures to prevent the diversion of income to foreign jurisdictions once the United States moves to the territorial regime, colloquially referred to as “base erosion provisions.”

Collectively, these provisions represent a significant shift in the taxation of multinational businesses; they also create some interesting state issues. Unlike the federal system, which has historically taxed multinational businesses on a worldwide basis, states have largely used a territorial approach, including income from wherever earned in the tax base, then attributing income to an individual state through the use of formulary apportionment. In addition, states often take additional steps to deal with foreign-source income, including the use of dividends received deductions for dividends paid by foreign subsidiaries to U.S. parent corporations, subtractions from the tax base for subpart F income, or general exclusions from the tax base for foreign-source income.

There is substantial variation across the states with respect to how foreign income generally, and subpart F income specifically, is handled. As noted in more detail below, the repatriation inclusion amounts under the new law are treated for federal purposes as an addition to subpart F income. The state treatment of subpart F income is far from consistent across states. Certain states provide a specific exclusion from the state tax base for subpart F income. Other states administratively extend their foreign dividends-received deduction to subpart F income. A number of states simply do not address subpart F income. Additionally, many states disallow expenses associated with any subpart F income not taxed by the state. These issues are not new, but will likely require closer examination due to the magnitude of the amounts required to be repatriated and included in federal income under provisions of the new law.

For states, the dormant foreign commerce clause arising under the U.S. constitution inserts another layer of complexity to the analysis of state taxation of foreign-source income. Unlike the federal government, states are prohibited from taxing foreign income or entities engaged in foreign commerce less favorably than domestic counterparts. The essential principle applicable here was provided by the U.S. Supreme Court in *Kraft General Foods v. Iowa Department of Revenue*, in which the Court determined that Iowa’s conformity to federal tax law was an unconstitutional violation of the foreign commerce clause because it resulted in discriminatory treatment of dividends received from foreign affiliates as compared to domestic affiliates. This mandate to avoid discriminating against foreign commerce requires an examination of any state inclusion of foreign-source income (remaining in the state tax base after the application of state-specific subtraction rules) to ensure the foreign income is not taxed more heavily than similarly situated income from domestic sources. To complicate matters further, the application of this principle may differ depending on whether the state is a separate filing state or a state in which a corporate taxpayer files its returns on a combined or consolidated basis.

Establish a territorial tax system

— **Deduction for foreign-source dividends received.** The territorial system encompassed in the new law allows a dividends received deduction (DRD) for 100% of the foreign-source portion of dividends received from a foreign corporation in which the U.S. recipient owns 10% or more of the voting stock (subject to certain holding period requirements). A “hybrid” dividend is not eligible for this deduction. A hybrid dividend is a dividend paid by the foreign subsidiary for which it received a deduction or other tax benefit in a foreign country. Instead, any hybrid dividend received by a CFC from another CFC is treated as subpart F income for the U.S. shareholders.

States often do not conform to the federal tax treatment of foreign affiliate dividends. Many states apply their DRDs in the same manner to both foreign and domestic dividends to avoid unconstitutionally discriminating against foreign dividends in violation of the foreign commerce clause. A number of states, but certainly not all, already allow a 100% DRD for dividends from foreign corporations. Some

allow only a partial DRD, but tax an equal portion of domestic and foreign dividends. Many states also provide a subtraction from taxable income for subpart F income, either in the form of a specific exclusion of some or all subpart F income or a DRD that includes subpart F income. As a result of the new law, taxpayers will need to evaluate how a state conforms to the federal DRD as well as its treatment of subpart F income, thus determining whether the dividends qualify for deduction or exclusion under state law.

Transition to the territorial system

- To transition to the territorial system, the new law requires a deemed repatriation of post-1986 earnings and profits (E&P) of certain foreign corporations and subjects those amounts to reduced federal tax rates depending on whether the E&P relates to cash and cash equivalents or other assets. This is accomplished by adding the post-1986 E&P to the U.S. shareholders' subpart F income and then allowing a partial deduction of those included amounts to effectively arrive at the applicable preferential tax rates. The effective preferential rates on repatriated earnings in the new law are 15.5% for cash and cash equivalents and 8% for other amounts. This income inclusion is required in "the last tax year beginning before January 1, 2018." The new law allows taxpayers the option of preserving NOLs, rather than using such NOLs to offset the deemed repatriated E&P.

Certain state issues flow from this mandatory repatriation. Those issues include the interaction between the mechanics of the way deemed repatriated amounts are included in a U.S. taxpayer's federal gross income and the state modifications to federal taxable income that generally apply to subpart F income and foreign dividends. For example, the repatriated amount does not fall within the Code section 952 definition of subpart F income in the Code, but is an amount added to a taxpayer's subpart F income to be included in federal gross income. That raises questions of whether a state's subpart F modification provision will apply to the repatriated amount. Even where the state's subpart F modification will include the repatriated amount, the reduction in some states is less than 100% of that income, resulting in the potential for some residual state taxable income resulting from the repatriation. Further, the foreign commerce clause could be implicated if the undistributed earnings of similarly situated domestic subsidiaries are not similarly subject to tax. In states that automatically conform to the Code, confusion could arise when computing the amount of income to be included on the state return due to the overlapping limitations provided in the new law and a state's DRD (or the subpart F exclusion that might otherwise apply).

The new law allows the federal tax on repatriated earnings to be paid over eight years, a provision that will not likely be picked up by a state without legislative action (state conformity to the Code generally applies to the calculation of taxable income and not to the tax on that income). As a result, the full amount of any state tax attributable to the repatriation may need to be paid in a single year rather than spread over the eight-year federal

installment period. Paying the federal tax on repatriated income in installments will also affect the timing of any deductions for federal income tax paid in the handful of states that permit a deduction for federal taxes.

Establish measures to prevent base erosion

The new law includes several sections that address potential base erosion on both outbound and inbound transactions. A number of state issues flow from these new rules. Of critical importance is the foreign commerce clause prohibition against discriminating against foreign commerce, even if the differential treatment is the result of conformity to the federal income tax code.

— **Rules related to passive and mobile income.** To address possible abuses related to certain types of income, the new law requires current recognition of a portion of certain income. The provision has potential consequences for state corporate income taxpayers.

Under the agreement, a U.S. parent of a foreign subsidiary includes in gross income what is referred to as the global intangible low-taxed income (GILTI) of the foreign subsidiary. The calculation of this income amount is complicated and is made based on certain enumerated attributes of the domestic corporation's foreign subsidiary. Regardless of whether the foreign subsidiary actually distributes this GILTI income, it must be included in the gross income of the U.S. parent. This income inclusion is required through the enactment of a new Code section (section 951A). The income included under this provision by the domestic parent is eligible for a potential deduction equal to 50% (37.5% for years beginning after December 31, 2025) of the foreign subsidiary's GILTI (subject to limitation when GILTI exceeds taxable income). This deduction is added as a new Code section (section 250).

While this provision requires GILTI to be treated as subpart F income for a number of purposes, it is not included in the definition of "subpart F income" under Code section 952. In addition, the explanatory statement accompanying the conference report specifically states that "GILTI inclusions do not constitute subpart F" income. Because the state exclusions from income (or qualification for a DRD) often refer to subpart F income or

to a specific definition of subpart F income (e.g., Code section 952), the exclusion or DRD provisions may not encompass this new income amount or the related deduction of a portion of the income amount. That raises the issue of a potential foreign commerce clause violation if this income earned by foreign affiliates would be taxed less favorably than similar income of domestic affiliates. For rolling conformity states with existing subpart F subtractions that might apply to GILTI, the addition of the 50% deduction for that income in new Code section 250 might lead to confusion as to how the state subtraction and federal deduction would interact.

— **Base erosion minimum tax.** The new base erosion provisions also include a "base erosion minimum tax" for certain inbound transactions. The tax is applicable to certain enterprises with average annual gross receipts in the preceding three years of at least \$500 million. The tax is based on the excess income that would have been reported by the domestic corporation without taking into account certain amounts paid to foreign affiliates. Given that this is a new, separate tax calculation, it is possible there will be no state tax effect because the tax would not cause a change to the taxable income of the corporation.

The above discussion has focused on whether certain foreign-source income will be included in the state income tax base and made note of the U.S. constitutional requirement for its treatment. Beyond this, there are a host of additional considerations that need to be taken into account in cases where some or all of the income gets included in the state tax base. For the most part, these considerations are not new. They include considerations of whether the income is unitary and subject to apportionment or non-unitary and subject to allocation. If subject to apportionment, taxpayers would need to consider the method used by individual states to source that type of income for apportionment factor purposes, which can differ depending on whether the income is from dividends, interest, capital gains, inventory sales, and the like. While not new issue, they will require careful analysis in light of the new law.

Closing thoughts

Given the recent enactment of the new law, four general observations relative to the potential impact on state taxes seem in order. **First**, from

a structural standpoint, the changes envisioned in the individual income tax appear likely to have a greater impact on the states. The repeal of personal exemptions and use of an enhanced child credit as the primary family size adjustment, the modifications to itemized deductions, and the new deduction for owners of passthrough entities could each have a significant impact on the yield and distribution of the personal income tax, depending on how the state responds. As it relates to purely domestic businesses, the impact would seem to be more modest given that the focal point of the federal reform is the substantial reduction in the corporate tax rate. There will likely be additional complexity as states and taxpayers try to coordinate different filing methods and current state law provisions in such areas as interest limitations, expensing and the like. Finally, the international provisions in the new law are far-reaching and pose substantial challenges in evaluating whether certain types of income will be included in a state return, how it should be sourced or allocated if it is included and whether the new treatment presents any potential constitutional challenges. The international changes are ones of kind rather than degree, and they may well overwhelm current state structures for taxing foreign-source income.

In evaluating how states might respond to the law changes, state taxpayers would be well-advised to keep in mind that the reaction to federal tax reform by individual states is likely to be driven, to a considerable extent, by the fiscal impact of conformity to the revised federal code. State balanced budget requirements can be expected to have an out-sized influence on whether and to what extent states conform to the federal changes. Simply put, states do not have the ability to run a deficit under their typical one- or two-year state budget cycles. While the additional complexity and compliance challenges associated with nonconformity will be evaluated, the fiscal concerns are likely to be paramount.

Second, there will be indirect effects as a result of federal tax reform that states must consider or are currently considering. Certain of the changes, such as curtailing the state and local income and sales tax deduction for individuals, increase the after-tax cost of state and local government at a time when federal resources are likely to be constrained and reduced federal assistance may be available.

Third, the timing of the federal reforms is problematic from a state perspective. Because the new law is effective for the 2018 tax year, many states will have a very limited time to assess the fiscal effects before the state legislatures convene. A few states have already proposed bills tying their conformity to a pre-reform period. State taxpayers will need to carefully monitor state legislation updating conformity statutes in 2018.

Finally, there is no “one size fits all” state or state taxpayer response to federal tax reform. The federal changes will affect each state differently and will need to be carefully analyzed by state tax administrators and state legislators before the state can formulate a response. The effect on corporate taxpayers varies widely and depends largely on the taxpayer’s particular situation, current state filing position, and industry.





Impact of tax reform on accounting for income taxes

KPMG observation

Companies will need to consider the timing of reversal of temporary differences that exist as of the enactment date. In measuring deferred tax assets (liabilities), existing tax laws and rates should continue to be utilized for temporary differences expected to reverse prior to the effective date. Despite the fact that deferred taxes are not generally determined on a daily basis, reasonable effort should be made to estimate such balances at the enactment date.

As a result of the blended rate application for the straddle year, these entities may need to schedule the reversal of enactment date temporary differences to determine which will reverse under the blended rate in fiscal 2018 and which temporary differences will reverse once the 21% is fully effective.

For a fiscal year-end entity, due to the application of Section 15 the change in the tax rate becomes administratively effective at the beginning of the taxpayer's fiscal year and therefore its impact on current taxes will be factored into the estimated annual effective tax rate in the period that includes the December 22, 2017 enactment date.

On December 22, 2017, President Trump signed H.R. 1, originally known as the Tax Cuts and Jobs Act, into law. The legislation will significantly impact an organization's accounting for income taxes process and measurement of income taxes related balances, beginning with the December 22, 2017 date of enactment. As entities assess the impact of the new legislation, there may be elements where it is not entirely clear how a court would interpret the law. Accordingly, companies should also assess the impact the new law will have on the accounting for uncertainty in income taxes. If there are tax positions expected to be reported on a tax return that are not more likely than not or are not highly certain to be sustained upon examination based on the technical merits, an entity should determine the appropriate amount of unrecognized tax benefits to reflect within the financial statements.

This discussion highlights selected areas of accounting for income taxes that companies may see impacted by changes in tax laws or rates included in the new legislation, but is not all inclusive. For other areas of the law, it is not currently clear how the authoritative accounting guidance applies. Refer to KPMG's publication [Tax Reform, Supplement to KPMG's Handbook, Accounting for Income Taxes](#), for additional accounting for income taxes considerations.

Corporate tax rate reduction

The tax law reduces the corporate tax rate to 21% effective January 1, 2018. In accordance with Section 15, fiscal year-end entities utilize a blended rate for the tax year that straddles the effective date by applying a prorated percentage of the number of days prior to and subsequent to the January 1, 2018 effective date.

The tax effect of changes in tax laws or rates on income taxes receivable (payable) for the current year is recognized in the estimated annual effective tax rate beginning in the interim period which includes the latter of the date the legislation is enacted or effective. To the extent income taxes receivable (payable) of prior years are adjusted, such impacts are recognized in income tax expense (benefit) from continuing operations as of the date of enactment.

Deferred tax assets (liabilities) are remeasured to reflect the effects of enacted changes in tax laws or rates at the December 22, 2017 date of enactment, even though the changes are not effective until future periods. The impact of the remeasurement is reflected entirely in the interim period that includes the December 22, 2017 enactment date and allocated directly to income tax expense (benefit) from continuing operations.

KPMG observation

At the date of enactment, entities may need to remeasure deferred tax assets associated with share-based compensation or other compensation-related deferred tax assets to the extent the compensation does not meet the written binding contract exception and is not anticipated to be deductible in the future. Further, entities should apply existing policies on the determination of the portion of compensation related temporary differences that will be deductible in the future noting that the two most common methods used in practice are pro rata (between cash and noncash compensation) or stock compensation last.

Due to the anticipated increase in future nondeductible compensation expense, an entity will need to consider the potential reduction in deferred tax assets and increase in future taxable income on its valuation allowance judgment.

KPMG observation

The incorporation of a limitation on the deductibility of interest expense may result in an increase in future taxable income and the effective tax rate. If an entity anticipates increases in future taxable income as a result of the limitation, existing valuation allowance judgments should be reassessed to determine if a change in judgment on the realizability of noninterest-related federal deferred tax assets occurs. Further, entities may need to consider the limitation on the utilization of disallowed interest expense carryforwards in scheduling the reversal of deferred tax assets on a go-forward basis.

Excessive executive compensation

In accordance with the new tax law, the covered employees subject to the excessive executive compensation limitation will be the principal executive officer, principal financial officer, and three other highest paid officers. Once an employee is a covered person for a tax year beginning after December 31, 2016, the employee will remain classified as such for all future years. The legislation eliminates the exceptions for commissions and performance-based compensation. The effective date of such provisions are for tax year beginning after December 31, 2017 but will not apply to certain compensation under pre-November 2, 2017 written binding contracts.

Interest expense limitation

Interest expense, net of interest income, will be permitted as a deduction to the extent it does not exceed 30% of adjusted taxable income for tax years beginning after December 31, 2017. Adjusted taxable income is computed without regard to deductions allowable for interest, depreciation, amortization, or depletion for tax years beginning after December 31, 2017 and before January 1, 2022. Subsequent to such date, adjusted taxable income is computed without regard to deductions allowable for interest. Any disallowed interest expense is carried forward indefinitely.

Net operating losses

Net operating losses (NOLs) arising in tax years beginning after December 31, 2017 will be limited to 80% of taxable income. NOLs arising in tax years ending after December 31, 2017 will be permitted to be carried forward indefinitely, while no carryback is permitted for NOL generated in those years. For most taxpayers, existing NOL carryforwards arising in tax years beginning before January 1, 2018 are not subject to the 80% limitation; however, such carryforwards remain subject to the 20-year carryforward period.

Alternative minimum tax

The law repeals the corporate alternative minimum tax regime and permits existing minimum tax credits to offset the regular tax liability for any tax year. Further, the credit is refundable for any tax year beginning after December 31, 2017 and before December 31, 2020 in an amount equal to 50% of the excess of the minimum tax credit over the allowable credit for the year against the regular tax liability. Any unused minimum tax credit carryforward is refundable in the following year.

Mandatory repatriation

The legislation provides that the aggregate of post-1986 earnings and profits (E&P) are deemed repatriated for the last tax year of a foreign corporation beginning prior to January 1, 2018 based upon the greater of E&P measured at November 2, 2017 or December 31, 2017. E&P is taxed at a rate of 15.5% and 8% for cash and non-cash earnings, respectively. While the deemed repatriation is included in taxable income in the last tax year beginning prior to January 1, 2018, an election may be made to pay the liability over an eight year period under a prescribed methodology. Future dividends of future earnings generally may be remitted without federal tax consequences.

KPMG observation

Companies may need to perform additional scheduling of the reversal of temporary differences in determining the total amount of deferred tax assets supported by reversing taxable temporary differences. An entity may need to consider the reversal of temporary differences and the offset of taxable and deductible temporary difference prior to the consideration of the availability of NOL carryforwards in order to determine the portion of deferred tax assets for NOLs supported. Further, as NOL carryforwards arising in tax years ending after December 31, 2017 have an indefinite carryforward period, we believe the deferred tax assets related to such NOLs may be supported by taxable temporary differences associated with indefinite life assets, but consideration should be given to the 80% limitation.

KPMG observation

In certain circumstances, a company may be able to realize the economic benefit of its alternative minimum tax credits and recognize an asset for those credits.

KPMG observation

An entity will generally reflect an income taxes payable balance associated with the deemed repatriation in the tax year of inclusion. Such amount is anticipated to be classified as a current or noncurrent income taxes payable based upon the expected timing of cash payment (current if anticipated to be paid within 12 months or the operating cycle, otherwise noncurrent). This provision will generally require an entity to verify the accuracy of its E&P and related tax pools within the annual or interim period which includes the December 22, 2017 date of enactment.

Further, while future dividends are generally not subject to tax consequences upon remittance, entities may still need to consider the applicability of the indefinite reinvestment criteria as it relates to items such as withholding taxes or state income taxes imposed on actual distributions or currency transaction gains (losses) that would result in taxation upon remittance.

Finally, entities may need to consider the realizability of remaining foreign tax credit carryforwards based on their ability to generate future general basket foreign source income.

KPMG observation

In assessing the impact of foreign derived intangible income, it must be determined whether the deduction is considered to be similar to a special deduction. While special deductions are not anticipated in measuring deferred tax assets (liabilities), the future tax effects may impact the need for a valuation allowance on deferred tax assets if significant future special deductions are anticipated to reduce taxable income in future periods to a level which will not be sufficient to realize the benefits of existing deferred tax assets.

KPMG observation

Entities may need to consider disclosure of the effects of enactment in the footnotes to the financial statements, within management discussion and analysis (MD&A) or within risk factors. Within the footnotes, entities are required to disclose income tax expense (benefit) arising from adjustments of deferred tax assets (liabilities) and income taxes receivable (payable) for enacted changes in tax laws or rates. For certain entities, the tax law was enacted subsequent to the end of the financial reporting period but prior to issuance of its interim or annual financial statements. Those entities may need to disclose the nature of the event and an estimate of its financial effect or a statement that such an estimate cannot be made.

Within MD&A, entities may consider disclosing expected future effective tax rates as well as future obligations regarding deemed mandatory repatriation if deferred to a future period. Additionally, to the extent future regulatory, administrative or legislative actions could have a materially adverse effect, additional disclosure within risk factors may be necessary.

Foreign-derived intangible income

The tax law permits U.S. corporations a deduction for tax years beginning after December 31, 2017 and before January 1, 2026 equal to 37.5% of the lesser of foreign-derived intangible income or its taxable income determined without regard to the deduction. Foreign-derived intangible income is deemed intangible income attributable to income received from a foreign person for sales of property or services for ultimate use outside the United States. The deduction is reduced to 21.875% for tax years beginning after December 31, 2025.

Financial statement disclosure

Summary

As noted above, this discussion highlights selective common areas of accounting for income taxes that may be impacted by the new law, but it is not all inclusive. The accounting may also be impacted by guidance issued by standard setters or regulators, if any. An entity's specific facts and circumstances should be assessed in determining the accounting for income taxes impact upon the December 22, 2017 enactment date.



Appendices

Appendix A:

JCX-67-17 (Conventional revenue estimate)

Appendix B:

JCX-68-17 (Distributional effects)

Appendix C:

JCX-69-17 (Macroeconomic analysis)

Appendix D:

KPMG list of new or revised procedural items in the new tax law

Appendix A: JCX-67-17 (Conventional revenue estimate)

Source: Joint Committee on Taxation

JOINT COMMITTEE ON TAXATION
December 18, 2017
JCX-67-17

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1, THE "TAX CUTS AND JOBS ACT"

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
I. Individual Tax Reform													
A. Simplification and Reform of Rates, Standard Deductions, and Exemptions													
1. 10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets (sunset 12/31/25) [1][2].....	tyba 12/31/17	-94.1	-135.3	-140.9	-146.4	-152.0	-158.1	-164.3	-171.1	-52.0	[3]	-668.7	-1,214.2
2. Modify standard deduction (\$12,000 for singles, \$24,000 for married filing jointly, \$18,000 for HoH) (sunset 12/31/25) [2].....	tyba 12/31/17	-57.2	-82.6	-84.7	-87.5	-90.7	-92.9	-95.7	-99.1	-30.0	[3]	-402.6	-720.4
3. Repeal of deduction for personal exemptions (sunset 12/31/25) [2].....	tyba 12/31/17	93.3	137.1	141.6	146.4	151.8	157.6	163.3	169.2	51.3	---	670.1	1,211.5
4. Alternative inflation measure [2].....	tyba 12/31/17	0.8	2.1	5.5	8.2	10.4	12.8	16.6	20.0	25.6	31.5	27.0	133.5
B. Treatment of Business Income of Individuals, Trusts, and Estates													
1. Allow 20 percent deduction of qualified business income and certain dividends for individuals and for gross income of agricultural or horticultural cooperatives (sunset 12/31/25) [4].....	generally tyba 12/31/17	-27.7	-47.1	-49.9	-51.8	-52.8	-52.2	-53.6	-53.2	-24.2	-1.9	-229.5	-414.5
2. Disallow active pass-through losses in excess of \$500,000 for joint filers, \$250,000 for all others (sunset 12/31/25).....	tyba 12/31/17	9.5	16.2	17.2	18.0	18.8	19.6	20.4	19.4	9.3	1.3	79.7	149.7
C. Reform of the Child Tax Credit													
1. Modification of child tax credit: \$2,000 not indexed; refundable up to \$1,400 indexed down to nearest \$100 base year 2018; \$2,500 refundability threshold not indexed; \$500 other dependents not indexed; phase outs \$2,000/\$400K not indexed (sunset 12/31/25) [2].....	tyba 12/31/17	-29.3	-67.7	-69.2	-70.4	-71.4	-73.8	-74.9	-76.0	-40.7	---	-308.1	-573.4
2. Require valid Social Security number of each child to claim refundable and non-refundable portions of child credit, non-child dependents and any child without a valid Social Security number still receives \$500 non-refundable credit (sunset 12/31/25) [2].....	tyba 12/31/17	---	3.9	3.8	3.8	3.7	3.8	3.7	3.7	3.0	0.5	15.2	29.8

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
D. Simplification and Reform of Deductions and Exclusions													
1. Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to \$10,000 in State and local taxes), interest on mortgage debt in excess of \$750K, interest on home equity debt, non-disaster casualty losses, and certain miscellaneous expenses (sunset 12/31/25) [2].....	generally tyba 12/31/17	43.5	70.4	72.0	77.1	82.3	87.9	94.0	100.2	41.1	---	345.3	668.4
2. Increase percentage limit for charitable contributions of cash to public charities (sunset 12/31/25).....	cmi tyba 12/31/17	---	---	---	---	---	---	---	---	---	---	---	---
3. Repeal of overall limitation on itemized deductions (sunset 12/31/25).....	tyba 12/31/17	---	---	---	---	---	---	---	---	---	---	---	---
4. Repeal exclusion for employer-provided bicycle commuter fringe benefit (sunset 12/31/25).....	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	---	[5]	[5]
5. Repeal exclusion for employer-provided qualified moving expense reimbursements (other than members of the Armed Forces) (sunset 12/31/25) [6][7].....	tyba 12/31/17	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.2	---	2.7	4.8
6. Repeal of deduction for moving expenses (other than members of the Armed Forces) (sunset 12/31/25).....	tyba 12/31/17	0.6	0.8	0.9	0.9	1.0	1.0	1.0	1.1	0.3	---	4.1	7.6
7. Limitation on wagering losses (sunset 12/31/25).....	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	---	0.1	0.1
E. Retirement Savings													
1. Repeal of special rule permitting recharacterization of Roth conversions.....	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.1	0.2
2. Length of service awards for public safety volunteers [8].....	tyba 12/31/17	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	0.1	0.1	0.1
3. Extended rollover period for certain plan loan offsets.....	tyba 12/31/17	---	---	---	---	---	---	---	---	---	---	---	---
F. Double Estate, Gift, and GST Tax Exemption Amount (sunset 12/31/25).....	dca & gma 12/31/17	-1.2	-8.1	-8.8	-9.1	-9.6	-10.1	-10.7	-11.1	-11.0	-3.3	-36.8	-83.0
G. Increase the Individual AMT Exemption Amounts and Phase-out Thresholds (sunset 12/31/25).....	tyba 12/31/17	-6.9	-82.5	-69.9	-74.9	-80.5	-81.6	-85.6	-90.1	-65.2	[3]	-314.7	-637.1
H. Reduce ACA Individual Shared Responsibility Payment Amount to Zero [2][9][10].....	miba 12/31/18	---	6.0	9.7	28.4	37.0	40.7	43.5	46.1	49.6	53.3	80.8	314.1
I. Other Provisions													
1. Restore a medical expense deduction for expenses in excess of 7.5 percent of adjusted gross income (sunset 12/31/18).....	tyba 12/31/16	-3.8	-1.4	---	---	---	---	---	---	---	---	-5.2	-5.2
2. Allow for increased contributions to ABLE accounts; allow saver's credit for ABLE contributions (sunset 12/31/25).....	tyba DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
3. Allow rollovers from 529 accounts to ABLE accounts (sunset 12/31/25).....	da DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]

----- Estimate Included in Item I.D.1. -----

----- Estimate Included in Item I.D.1. -----

----- Negligible Revenue Effect -----

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
4. Extend time limit for contesting IRS levy.....	[11]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
5. Treatment of certain individuals performing services in the Sinai Peninsula of Egypt (sunset 12/31/25).....	spo/a 6/9/15	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	---	[3]	[3]
6. Treatment of student loans discharged on account of death or disability (sunset 12/31/25).....	doa 12/31/17	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1
7. Allow 529 withdrawals up to \$10,000 for primary and secondary education.....	da 12/31/17	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
8. Retirement plan and casualty loss relief for any area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Relief and Emergency Assistance Act during 2016.....	DOE	-3.2	-1.3	[5]	[5]	[3]	[3]	[3]	[3]	[3]	[3]	-4.6	-4.6
9. Repeal of deduction for alimony payments and corresponding inclusion in income.....	generally dosacia 12/31/18	---	0.1	0.2	0.4	0.5	0.7	0.9	1.1	1.4	1.7	1.2	6.9
Total of Individual Tax Reform		-75.3	-188.8	-171.9	-156.3	-150.8	-144.0	-140.9	-139.2	-41.4	83.0	-744.0	-1,126.6
II. Business Tax Reform													
A. Repeal of Alternative Minimum Tax on Corporations [2]....	tyba 12/31/17	-6.8	-6.9	-6.6	-6.8	-7	-1.3	-1.3	-1.3	-1.2	-1.1	-34.0	-40.3
B. 21 Percent Corporate Tax Rate.....	tyba 12/31/17	-101.3	-125.3	-130.5	-131.1	-132.6	-136.2	-140.7	-144.7	-149.7	-156.3	-620.8	-1,348.5
C. Small Business Reforms													
1. Increase section 179 expensing to \$1 million with a phaseout range beginning at \$2.5 million and expand definition of qualified property.....	ppisi tyba 12/31/17	-4.7	-7.4	-4.1	-2.6	-2.0	-1.5	-1.0	-0.9	-0.9	-0.9	-20.8	-25.9
2. Simplified accounting for small business.....	[12]	-7.6	-7.5	-3.3	-2.1	-1.7	-1.5	-1.6	-1.7	-1.7	-1.8	-22.1	-30.5
D. Cost Recovery, etc.													
1. Extension, expansion, and phase down of bonus depreciation (sunset 12/31/26) [13].....	paas 9/27/17 apiasad & sppoga 9/27/17	-32.5	-36.5	-24.6	-14.2	-11.6	-4.9	3.3	8.4	12.5	13.7	-119.4	-86.3
2. Limit net interest deductions to 30 percent of adjusted taxable income, carryforward of denied deduction.....	tyba 12/31/17	8.4	17.7	19.7	19.6	24.9	30.2	29.6	31.8	34.7	36.9	90.2	253.4
3. Modify treatment of S corporation conversions into C corporations.....	DOE	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-2.8	-6.1
4. Modifications to depreciation limitations on luxury automobiles and personal use property.....	ppisa 12/31/17	---	---	---	---	---	---	---	---	---	---	---	---
5. Modifications of treatment of certain farm property.....	ppisa 12/31/17	[3]	[3]	[3]	-0.1	-0.2	-0.3	-0.2	-0.1	[3]	[3]	-0.4	-1.1
6. Modification of net operating loss deduction.....	lai tyba 12/31/17	6.4	10.0	11.1	15.9	25.2	34.1	36.0	30.2	20.8	11.4	68.5	201.1
7. Repeal like-kind exchanges except for real property.....	generally eoa 12/31/17	0.5	0.9	1.3	1.7	2.2	2.9	3.8	4.7	5.8	7.2	6.6	31.0
8. Applicable recovery period for real property.....	ppisa 12/31/17	-0.1	-0.1	-0.3	-0.4	-0.5	-0.7	-0.6	-0.7	-0.9	-0.6	-1.4	-4.9
9. Amortization of research and experimental expenditures.....	apoiu tyba 12/31/21	---	---	---	---	24.2	32.9	26.0	18.9	11.4	6.3	24.2	119.7
10. Expensing of certain costs of replacing citrus plants lost by reason of a casualty (sunset 12/22/27).....	apoiu DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]

----- Estimate Included in Item II.D.1. -----

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
E. Business-Related Deductions													
1. Repeal of deduction for income attributable to domestic production activities.....	tyba 12/31/17	4.3	8.9	9.3	9.6	9.9	10.3	10.7	11.1	11.6	12.2	42.1	98.0
2. Limitation on deduction by employers of expenses for fringe benefits:													
a. Meals and entertainment expenses, including meals for the convenience of the employer [14].....	apoa 12/31/17 & apoa 12/31/25	1.6	2.2	2.2	2.3	2.3	2.4	2.4	2.5	2.8	2.8	10.6	23.5
b. Repeal deduction for qualified transportation fringes, including commuting except as necessary for employee's safety [15].....	apoa 12/31/17	1.2	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	8.1	17.7
c. Clarification of tangible personal property deductible as employee achievement award.....	apoa 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
3. Eliminate deduction for member of Congress living expenses.....	tyba DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
4. UBTI increased by amount of certain fringe benefit expenses for which deduction is disallowed.....	apoa 12/31/17												
5. Repeal of rollover of publicly traded securities gain into specialized small business investment companies.....	sa 12/31/17	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	1.1	1.7
6. Certain self-created property not treated as a capital asset.....	Da 12/31/17	[3]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
F. Accounting Methods													
1. Certain special rules for taxable year of inclusion (in general).....	tyba 12/31/17	1.2	1.7	1.7	1.7	0.7	0.2	0.2	0.2	0.2	0.2	7.0	8.1
2. Certain special rules for taxable year of inclusion (related to original issue discount and other similar items).....	[16]	---	0.3	0.7	0.7	0.7	0.7	0.7	0.4	0.2	0.2	2.4	4.5
G. Business Credits													
1. Modification of credit for clinical testing expenses for certain drugs for rare diseases or conditions.....	apoi tyba 12/31/17	0.7	1.7	2.1	2.5	3.0	3.5	4.0	4.5	5.0	5.5	10.0	32.5
2. Modify rehabilitation credit to provide 20 percent historic credit ratably over 5 years, repeal credit for pre-1936 property.....	[17]	[5]	0.3	0.6	0.6	0.5	0.3	0.2	0.2	0.2	0.2	2.0	3.1
3. Provide a tax credit to certain employers who provide family and medical leave (sunset 12/31/19).....	tyba 12/31/17	-0.7	-1.5	-1.1	-0.5	-0.3	-0.2	---	---	---	---	-4.1	-4.3
H. Banks and Financial Instruments													
1. Limitation on deduction for FDIC premiums.....	tyba 12/31/17	0.5	1.5	1.5	1.5	1.5	1.6	1.6	1.6	1.7	1.7	6.5	14.8
2. Repeal of advance refunding bonds.....	ar bia 12/31/17	0.4	1.1	1.4	1.7	2.0	2.1	2.1	2.2	2.2	2.2	6.6	17.4
3. Repeal of tax credit bonds [2].....	bia 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.5
I. Compensation													
1. Modification of limitation on excessive employee remuneration, with transition rule [18].....	tyba 12/31/17	[5]	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.1	4.1	9.2

----- Estimate Included in Items II.E.2.b. -----

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27	
2. 21-percent excise tax on excess tax-exempt organization executive compensation (certain exceptions provided to non-highly compensated employees, and for certain medical services).....	tyba 12/31/17	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.8	
3. Treatment of qualified equity grants.....	[19]	-0.2	-0.2	-0.2	-0.2	-0.1	[3]	[3]	[3]	[3]	-0.1	-1.0	-1.2	
4. Increase the excise tax on stock compensation in an inversion from 15 percent to 20 percent.....	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	
J. Insurance														
1. Net operating losses of life insurance companies.....	lai tyba 12/31/17						<i>Estimate Included in Item II.D.6</i>							
2. Repeal of small life insurance company deduction.....	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.2	
3. Adjustment for change in computing reserves.....	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2	
4. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account.....	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	
5. Modification of proration rules for property and casualty insurance companies.....	tyba 12/31/17	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.0	2.1	
6. Repeal of special estimated tax payments.....	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	
7. Computation of life insurance reserves.....	tyba 12/31/17	0.9	1.7	1.7	1.7	1.8	1.8	1.8	1.9	1.2	0.6	7.9	15.2	
8. Modification of rules for life insurance proration.....	tyba 12/31/17	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.6	
9. Capitalization of certain policy acquisition expenses.....	tyba 12/31/17	0.1	0.4	0.6	0.7	0.7	0.8	0.9	0.9	1.0	1.1	2.5	7.2	
10. Tax reporting for life settlement transactions.....	generally tyba 12/31/17	[3]	[3]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.1	[5]	0.2	
11. Clarification of tax basis of life insurance contracts.....	generally teia 8/25/09													
12. Exception to transfer for valuable consideration rules.....	ta 12/31/17													
13. Modification of property and casualty insurance company discounting rules.....	tyba 12/31/17	0.3	1.8	1.8	1.8	1.8	1.8	1.7	1.4	0.6	0.3	7.5	13.2	
K. Partnerships														
1. Tax gain on the sale of a partnership interest on look-thru basis.....	seado/a 11/27/17 & seada 12/31/17	[5]	0.2	0.3	0.3	0.4	0.5	0.5	0.5	0.5	0.6	1.2	3.8	
2. Expand the definition of substantial built-in loss for purposes of partnership loss transfers.....	topia 12/31/17	[3]	[3]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5	
3. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss.....	tyba 12/31/17	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.2	
4. Repeal of technical termination of partnerships.....	pyba 12/31/17	0.1	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.7	1.6	
L. Tax-Exempt Organizations														
1. Excise tax based on investment income of private colleges and universities with endowment per student of at least \$500,000.....	tyba 12/31/17	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.8	
2. Unrelated business taxable income separately computed for each trade or business activity.....	tyba 12/31/17	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	1.6	3.5	

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
3. Charitable deduction not allowed for amounts paid in exchange for college athletic event seating rights.....	cmi tyba 12/31/17	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	2.0
4. Repeat substantiation exception for charitable contributions reported by donee organization.....	cmi tyba 12/31/16												
----- Negligible Revenue Effect -----													
M. Other Provisions													
1. Modify tax treatment of Alaska Native Corporations and Settlement Trusts.....	[20]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1
2. Expansion of qualifying beneficiaries of an electing small business trust, and modify charitable contribution deduction for electing small business trusts.....	1/1/18 feoqb & tyba 12/31/17 fe	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.3
3. Craft beverage modernization and tax reform (sunset 12/31/19).....	generally 1/1/18	-1.6	-1.5	-1.1	---	---	---	---	---	---	---	-4.2	-4.2
4. Exempt amounts paid for aircraft management services from the excise taxes imposed on transportation by air.....	apa DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
5. Create qualified opportunity zones.....	DOE	-1.2	-1.7	-1.6	-1.7	-1.6	-1.5	-1.5	-1.6	8.1	2.7	-7.7	-1.6
6. Deny deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment.....	apoa DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
7. Expand provision relating to the non-deductibility of fines and penalties.....	apoi/a DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
8. Repeal of deduction for local lobbying expenses.....	apoi/a DOE	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
9. Revision of treatment of contributions to capital.....	[21]	0.1	0.2	0.4	0.7	1.0	1.0	0.9	0.8	0.7	0.6	2.5	6.5
10. Recharacterization of certain gains on property held for fewer than 3 years in the case of partnership profits interest held in connection with performance of investment services.....	tyba 12/31/17	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7	1.1
Total of Business Tax Reform.....		-129.3	-133.8	-112.9	-92.5	-50.4	-16.4	-15.9	-24.1	-28.4	-49.4	-518.2	-653.8
III. International Tax Reform													
A. Establishment of Participation Exemption System for Taxation of Foreign Income													
1. Deduction for dividends received by domestic corporations from certain foreign corporations.....	[22]	-17.8	-28.1	-20.1	-20.3	-20.8	-21.0	-22.1	-23.2	-24.3	-25.8	-107.2	-223.6
2. Special rules relating to sales or transfers involving certain foreign corporations.....	da 12/31/17 & Ta 12/31/17	0.1	0.2	0.5	0.8	1.2	1.4	1.7	1.6	1.8	2.4	2.9	11.8
3. Treatment of deferred foreign income upon transition to participation exemption system of taxation and mandatory inclusion at two-tier rate (8-percent rate for illiquid assets, 15.5-percent rate for liquid assets).....	[23]	78.6	49.6	16.5	15.6	15.7	27.2	47.5	64.4	33.0	-9.4	176.0	338.8

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
B. Rules Related to Passive and Mobile Income													
1. Current year inclusion of global intangible low-taxed income, with deduction, by United States shareholders.....	tyba 12/31/17 [24]	7.7	12.5	9.6	9.5	9.3	9.0	9.2	9.3	15.1	21.2	48.6	112.4
2. Deduction for foreign-derived intangible income derived from trade or business within the United States.....	tyba 12/31/17	-0.2	4.8	6.9	6.6	0.2	-11.4	-15.7	-20.2	-18.4	-16.3	18.2	-63.8
C. Other Modifications of Subpart F Provisions													
1. Elimination of inclusion of foreign base company oil related income.....	[24]	-0.1	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.7	-1.4	-4.0
2. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment.....	[24]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
3. Modification of stock attribution rules for determining status as a controlled foreign corporation.....	[25]	----- Estimate Included in Item III.A.I. -----											
4. Modification of definition of United States shareholder.....	[24]	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7
5. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply.....	[24]	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3
D. Prevention of Base Erosion													
1. Limitation on income shifting through intangible property transfers.....	ti tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.3
2. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities.....	tyba 12/31/17	----- Estimate Included in Item III.A.I. -----											
3. Dividends received from post-enactment surrogate foreign corporations not qualified dividend income.....	dra DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1
E. Modifications Related to Foreign Tax Credit System													
1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis.....	[24]	----- Estimate Included in Item III.A.I. -----											
2. Separate foreign tax credit limitation basket for foreign branch income.....	tyba 12/31/17	----- Estimate Included in Item III.B.I. -----											
3. Source of income from sales of inventory determined solely on basis of production activities.....	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.5
4. Increase maximum overall domestic loss recapture to 100 percent for pre-2018 losses.....	tyba 12/31/17	-0.6	-1.1	-1.0	-0.6	0.1	0.4	0.1	0.1	0.1	0.1	-3.2	-2.3
F. Inbound Provisions													
1. Base erosion and anti-abuse tax.....	apooa 12/31/17	0.8	4.3	13.3	16.1	17.1	16.8	15.9	16.5	21.6	27.0	51.7	149.6
G. Other Provisions													
1. Restriction on insurance business exception to passive foreign investment company rules.....	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.1

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
2. Repeal of fair market value method of interest expense apportionment.....	tyba 12/31/17	[5]	0.1	0.1	0.1	[5]	[5]	[5]	[5]	[5]	[5]	0.3	0.6
Total of International Tax Reform		68.9	42.6	26.0	28.0	22.9	22.5	36.7	48.7	29.1	-0.8	188.2	324.4
NET TOTAL		-135.7	-280.0	-258.8	-220.8	-178.3	-137.9	-120.1	-114.6	-40.6	32.9	-1,074.0	-1,456.0

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is generally assumed to be December 22, 2017.

Legend for "Effective" column:

- apa = amounts paid after
- apisasd = and placed in service after such date
- apooaa = amounts paid or accrued after
- apooia = amounts paid or incurred after
- apooii = amounts paid or incurred in
- apooio/a = amounts paid or incurred on or after
- ar = advance refunding
- bia = bonds issued after
- cmi = contributions made in
- da = distributions after
- Da = dispositions after
- dda = decedents dying after

- DOE = date of enactment
- doia = discharges of indebtedness after
- dosaacia = divorce or separation agreements entered into after
- eca = exchanges completed after
- fc = for charitable
- feoqpb = for expansion of qualifying beneficiaries
- gma = gifts made after
- lai = losses accrued in
- mba = months beginning after
- paa = property acquired after
- ppisa = property placed in service after
- ptyba = partnership taxable years beginning after
- sa = sales after

- seada = sales exchanges and dispositions after
- seado/a = sales, exchanges and dispositions on or after
- spoo/a = service provided on or after
- spooqa = specified plants planted or grafted after
- ta = transactions after
- Ta = transfers after
- teia = transactions entered into after
- ti = transfers in
- topia = transfers of partnership interests after
- tyba = taxable years beginning after

[Footnotes for JCX-67-17 appear on the following pages]

Footnotes for JCX-67-17:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
[1] The parameters for the beginning of the 24%, 32%, 35%, and 37% rate brackets, and the standard deduction amount use 2018 as the base year. Other indexed parameters are adjusted for inflation from their 2017 values using the chained CPI-U as the inflation measure to determine 2018 values.												
[2] Estimate includes the following outlay effects:												
10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets.....	---	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.3	---	4.4	9.3
Modify standard deduction.....	---	9.4	9.7	10.1	10.3	10.5	10.6	10.7	10.9	---	39.6	82.3
Repeal of deduction for personal exemptions.....	-10.8	-16.0	-16.4	-16.7	-17.0	-17.3	-17.5	-17.8	-5.4	---	-77.0	-134.9
Alternative inflation measure.....	---	-0.3	-0.6	-1.3	-1.6	-2.1	-2.5	-3.1	-3.6	-4.1	-3.9	-19.3
Modification of child tax credit.....	---	21.8	22.1	22.0	22.0	23.1	23.1	23.1	24.1	---	87.9	181.3
Require valid Social Security number of each child to claim refundable and non-refundable portions of child credit, non-child dependents and any child without a valid Social Security number still receives \$500 non-refundable credit.....	---	-3.0	-2.9	-2.8	-2.7	-2.7	-2.7	-2.6	-2.6	-0.5	-11.4	-22.4
Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to \$10,000 in State and local taxes), interest on mortgage debt in excess of \$750K, interest on home equity debt, non-disaster casualty losses and certain miscellaneous expenses.....	---	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	---	-0.8	-1.7
Reduce ACA individual shared responsibility payment amount to zero.....	---	-5.8	-12.7	-28.2	-35.2	-38.4	-40.7	-43.0	-45.3	-48.0	-81.9	-297.3
Repeal of alternative minimum tax on corporations.....	2.2	2.3	1.7	1.9	1.9	---	---	---	---	---	10.2	10.2
Repeal of tax credit bonds.....	[26]	[26]	[26]	[26]	[26]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
[3] Loss of less than \$50 million.												
[4] Estimate includes the following budget effects:												
Total Revenue Effect (SECA interaction).....	-1.4	-1.9	-1.7	-1.5	-1.1	1.5	2.5	1.7	1.2	0.8	-7.7	[3]
On-budget effects.....	-0.3	-0.4	-0.4	-0.3	-0.2	0.3	0.5	0.4	0.2	0.2	-1.6	[3]
Off-budget effects.....	-1.1	-1.5	-1.4	-1.2	-0.9	1.2	2.0	1.3	0.9	0.6	-6.1	[3]
[5] Gain of less than \$50 million.												
[6] Estimate includes the following budget effects:												
Total Revenue Effect.....	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.2	---	2.7	4.8
On-budget effects.....	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.1	---	2.1	3.8
Off-budget effects.....	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	---	---	0.6	1.0
[7] Estimate includes policy that retains exclusion under section 217(g) (related to members of the Armed Forces).												
[8] Estimate includes the following budget effects:												
Total Revenue Effect.....	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
On-budget effects.....	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	[1]	-0.3
Off-budget effects.....	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	[3]	-0.2
[9] Estimate provided by the Joint Committee on Taxation staff in collaboration with the Congressional Budget Office.												

[Footnotes for JCX-67-17 continue on the following page]

Appendix B: JCX-68-17 (Distributional effects)

Source: Joint Committee on Taxation

JOINT COMMITTEE ON TAXATION
December 18, 2017
JCX-68-17

**DISTRIBUTIONAL EFFECTS OF
THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"**

Calendar Year 2019

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
Less than \$10,000.....	-\$396	-5.6%	\$7.0	0.2%	\$6.6	0.2%	9.1%	8.6%
\$10,000 to \$20,000.....	-\$1,792	(5)	-\$2.4	-0.1%	-\$4.2	-0.1%	-0.7%	-1.2%
\$20,000 to \$30,000.....	-\$2,982	-13.5%	\$22.1	0.7%	\$19.1	0.6%	3.9%	3.4%
\$30,000 to \$40,000.....	-\$5,416	-11.5%	\$47.0	1.5%	\$41.5	1.4%	7.9%	7.0%
\$40,000 to \$50,000.....	-\$6,728	-10.0%	\$67.3	2.1%	\$60.6	2.0%	10.9%	9.9%
\$50,000 to \$75,000.....	-\$23,046	-8.7%	\$265.3	8.2%	\$242.3	8.2%	14.8%	13.5%
\$75,000 to \$100,000.....	-\$22,437	-8.0%	\$279.5	8.7%	\$257.1	8.7%	17.0%	15.6%
\$100,000 to \$200,000.....	-\$70,372	-7.5%	\$939.8	29.1%	\$869.4	29.3%	20.9%	19.4%
\$200,000 to \$500,000.....	-\$65,485	-9.0%	\$724.3	22.4%	\$658.8	22.2%	26.4%	23.9%
\$500,000 to \$1,000,000.....	-\$23,947	-9.4%	\$254.7	7.9%	\$230.8	7.8%	30.9%	27.8%
\$1,000,000 and over.....	-\$36,853	-5.9%	\$624.1	19.3%	\$587.2	19.8%	32.5%	30.2%
Total, All Taxpayers.....	-\$259,454	-8.0%	\$3,228.7	100.0%	\$2,969.3	100.0%	20.7%	19.0%

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- (1) This table is a distributional analysis of the proposal in revenue table JCX-67-17, excluding the following sections: I, Tax Reform for Individuals; D.4.-D.7., E.1-E.2, F., and I.2.-I.13. Under section H., the distribution analysis does not include the effect of the cost-sharing reductions and change in Medicaid spending.
- (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.
- (3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.
- (4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
- (5) For returns in the \$10,000 to \$20,000 income category, Federal taxes would decrease from -\$2.412 billion to -\$4.204 billion.

DISTRIBUTIONAL EFFECTS OF
THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"

Calendar Year 2021

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law Percent	Proposal Percent
Less than \$10,000.....	-\$60	-0.9%	\$6.9	0.2%	\$6.9	0.2%	8.2%	8.1%
\$10,000 to \$20,000.....	\$1,920	(5)	-\$4.9	-0.1%	-\$3.0	-0.1%	-1.4%	-0.8%
\$20,000 to \$30,000.....	\$1,948	8.6%	\$22.5	0.6%	\$24.5	0.7%	3.7%	4.0%
\$30,000 to \$40,000.....	-\$1,956	-4.1%	\$47.7	1.4%	\$45.7	1.4%	7.6%	7.3%
\$40,000 to \$50,000.....	-\$3,522	-4.8%	\$73.7	2.1%	\$70.1	2.1%	10.9%	10.4%
\$50,000 to \$75,000.....	-\$18,819	-6.6%	\$283.4	8.1%	\$264.6	8.1%	14.7%	13.7%
\$75,000 to \$100,000.....	-\$20,583	-6.9%	\$300.3	8.6%	\$279.8	8.5%	16.8%	15.6%
\$100,000 to \$200,000.....	-\$64,835	-6.4%	\$1,017.6	29.1%	\$952.7	29.1%	20.9%	19.6%
\$200,000 to \$500,000.....	-\$61,510	-7.7%	\$799.8	22.9%	\$738.3	22.5%	26.5%	24.4%
\$500,000 to \$1,000,000.....	-\$21,661	-7.8%	\$279.4	8.0%	\$257.8	7.9%	31.0%	28.4%
\$1,000,000 and over.....	-\$29,845	-4.4%	\$671.8	19.2%	\$642.0	19.6%	32.4%	30.7%
Total, All Taxpayers.....	-\$218,927	-6.3%	\$3,498.3	100.0%	\$3,279.4	100.0%	20.7%	19.3%

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- (1) This table is a distributional analysis of the proposal in revenue table JCX-67-17, excluding the following sections: 1. Tax Reform for Individuals: D.4-D.7., E.1-E.2., F., and I.2.-I.13. Under section H., the distribution analysis does not include the effect of the cost-sharing reductions and change in Medicaid spending.
- (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.
- (3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.
- (4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
- (5) For returns in the \$10,000 to \$20,000 income category, Federal taxes would increase from -\$4.888 billion to -\$2.969 billion.

DISTRIBUTIONAL EFFECTS OF
THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"

Calendar Year 2023

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal Percent
Less than \$10,000.....	\$278	4.3%	\$6.4	0.2%	\$6.7	0.2%	7.0%	7.3%
\$10,000 to \$20,000.....	\$3,044	(5)	-\$5.0	-0.1%	-\$2.0	-0.1%	-1.3%	-0.5%
\$20,000 to \$30,000.....	\$2,416	9.8%	\$24.7	0.7%	\$27.1	0.7%	3.7%	4.1%
\$30,000 to \$40,000.....	-\$202	-0.4%	\$51.0	1.4%	\$50.8	1.4%	7.6%	7.6%
\$40,000 to \$50,000.....	-\$2,127	-2.6%	\$80.9	2.1%	\$78.7	2.2%	10.8%	10.6%
\$50,000 to \$75,000.....	-\$14,944	-4.9%	\$305.2	8.1%	\$290.2	8.0%	14.6%	13.9%
\$75,000 to \$100,000.....	-\$16,558	-5.1%	\$325.9	8.6%	\$309.4	8.5%	16.6%	15.8%
\$100,000 to \$200,000.....	-\$49,535	-4.5%	\$1,103.4	29.3%	\$1,053.9	29.1%	20.8%	19.9%
\$200,000 to \$500,000.....	-\$46,640	-5.4%	\$863.6	22.9%	\$816.9	22.5%	26.5%	25.0%
\$500,000 to \$1,000,000.....	-\$14,015	-4.7%	\$297.6	7.9%	\$283.5	7.8%	30.8%	29.2%
\$1,000,000 and over.....	-\$9,833	-1.4%	\$717.5	19.0%	\$707.7	19.5%	32.2%	31.5%
Total, All Taxpayers.....	-\$148,113	-3.9%	\$3,771.1	100.0%	\$3,623.0	100.0%	20.5%	19.7%

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- (1) This table is a distributional analysis of the proposal in revenue table JCX-67-17, excluding the following sections: 1. Tax Reform for Individuals: D.4-D.7., E.1-E.2., F., and I.2.-I.13. Under section H., the distribution analysis does not include the effect of the cost-sharing reductions and change in Medicaid spending.
- (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.
- (3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.
- (4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
- (5) For returns in the \$10,000 to \$20,000 income category, Federal taxes would increase from -\$5,044 billion to -\$2,000 billion.

DISTRIBUTIONAL EFFECTS OF
THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"

Calendar Year 2025

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law Percent	Proposal Percent
Less than \$10,000.....	\$314	5.3%	\$5.9	0.1%	\$6.2	0.2%	5.8%	6.1%
\$10,000 to \$20,000.....	\$2,847	(5)	-\$4.7	-0.1%	-\$1.8	0.0%	-1.1%	-0.4%
\$20,000 to \$30,000.....	\$2,980	11.0%	\$27.2	0.7%	\$30.2	0.8%	3.8%	4.2%
\$30,000 to \$40,000.....	\$105	0.2%	\$53.7	1.3%	\$53.8	1.4%	7.5%	7.5%
\$40,000 to \$50,000.....	-\$1,701	-1.9%	\$88.0	2.2%	\$86.3	2.2%	10.9%	10.6%
\$50,000 to \$75,000.....	-\$14,349	-4.4%	\$328.1	8.0%	\$313.8	8.0%	14.5%	13.9%
\$75,000 to \$100,000.....	-\$16,652	-4.8%	\$350.6	8.6%	\$333.9	8.5%	16.5%	15.7%
\$100,000 to \$200,000.....	-\$48,439	-4.0%	\$1,197.4	29.3%	\$1,148.9	29.1%	20.7%	19.9%
\$200,000 to \$500,000.....	-\$47,460	-5.0%	\$943.3	23.1%	\$895.8	22.7%	26.5%	25.1%
\$500,000 to \$1,000,000.....	-\$13,623	-4.2%	\$321.5	7.9%	\$307.8	7.8%	30.8%	29.3%
\$1,000,000 and over.....	-\$9,600	-1.2%	\$780.2	19.1%	\$770.6	19.5%	32.1%	31.5%
Total, All Taxpayers.....	-\$145,581	-3.6%	\$4,091.1	100.0%	\$3,945.5	100.0%	20.5%	19.7%

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) This table is a distributional analysis of the proposal in revenue table JCX-67-17, excluding the following sections: 1. Tax Reform for Individuals: D.4-D.7., E.1-E.2., F., and I.2.-I.13. Under section H., the distribution analysis does not include the effect of the cost-sharing reductions and change in Medicaid spending.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items,

[8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

(3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change.

Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

(5) For returns in the \$10,000 to \$20,000 income category, Federal taxes would increase from -\$4.664 billion to -\$1.817 billion.

DISTRIBUTIONAL EFFECTS OF
THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"

Calendar Year 2027

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Average Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal Percent
Less than \$10,000.....	\$383	7.3%	\$5.2	0.1%	\$5.6	0.1%	4.7%	5.1%
\$10,000 to \$20,000.....	\$6,487	(5)	-\$3.4	-0.1%	\$3.1	0.1%	-0.8%	0.7%
\$20,000 to \$30,000.....	\$8,359	26.6%	\$31.4	0.7%	\$39.7	0.9%	4.1%	5.1%
\$30,000 to \$40,000.....	\$4,864	8.2%	\$59.4	1.3%	\$64.3	1.4%	7.6%	8.3%
\$40,000 to \$50,000.....	\$4,317	4.4%	\$98.0	2.2%	\$102.3	2.3%	11.0%	11.5%
\$50,000 to \$75,000.....	\$4,060	1.2%	\$352.2	7.9%	\$356.3	8.0%	14.5%	14.6%
\$75,000 to \$100,000.....	-\$1,037	-0.3%	\$380.3	8.6%	\$379.3	8.5%	16.3%	16.3%
\$100,000 to \$200,000.....	-\$5,993	-0.5%	\$1,302.4	29.3%	\$1,296.4	29.1%	20.7%	20.6%
\$200,000 to \$500,000.....	-\$5,890	-0.6%	\$1,026.5	23.1%	\$1,020.6	22.9%	26.6%	26.4%
\$500,000 to \$1,000,000.....	-\$3,099	-0.9%	\$345.7	7.8%	\$342.6	7.7%	30.8%	30.5%
\$1,000,000 and over.....	-\$8,495	-1.0%	\$848.7	19.1%	\$840.2	18.9%	32.1%	31.7%
Total, All Taxpayers.....	\$3,958	0.1%	\$4,446.4	100.0%	\$4,450.3	100.0%	20.5%	20.5%

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- (1) This table is a distributional analysis of the proposal in revenue table JCX-67-17, excluding the following sections: 1. Tax Reform for Individuals: D.4-D.7., E.1-E.2., F., and I.2.-I.13. Under section H., the distribution analysis does not include the effect of the cost-sharing reductions and change in Medicaid spending.
- (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.
- (3) Federal taxes are equal to individual income tax (including the outlay portion of refundable credits), employment tax (attributed to employees), excise taxes (attributed to consumers), and corporate income taxes. The estimates of Federal taxes are preliminary and subject to change. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis. Does not include indirect effects.
- (4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
- (5) For returns in the \$10,000 to \$20,000 income category, Federal taxes would increase from -\$3,415 billion to \$3,072 billion.

JOINT COMMITTEE ON TAXATION
December 18, 2017
JCX-68-17

**DISTRIBUTIONAL EFFECTS OF
THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"**

Distribution of Individual Income Tax Side of the Proposal

INCOME CATEGORY	CHANGE IN FEDERAL TAXES (\$ millions)				
	2019	2021	2023	2025	2027
Less than \$10,000.....	-\$127	\$88	\$156	\$169	\$475
\$10,000 to \$20,000.....	-\$1,206	\$2,175	\$2,645	\$2,459	\$6,744
\$20,000 to \$30,000.....	-\$2,279	\$2,392	\$2,169	\$2,693	\$9,004
\$30,000 to \$40,000.....	-\$4,469	-\$1,335	-\$438	-\$194	\$5,719
\$40,000 to \$50,000.....	-\$5,533	-\$2,656	-\$2,341	-\$2,015	\$5,535
\$50,000 to \$75,000.....	-\$18,887	-\$15,831	-\$15,493	-\$15,245	\$8,112
\$75,000 to \$100,000.....	-\$17,279	-\$16,973	-\$17,140	-\$17,630	\$3,526
\$100,000 to \$200,000.....	-\$51,409	-\$51,510	-\$51,494	-\$51,832	\$10,313
\$200,000 to \$500,000.....	-\$47,008	-\$48,721	-\$49,435	-\$51,435	\$7,649
\$500,000 to \$1,000,000.....	-\$16,031	-\$16,251	-\$15,840	-\$15,845	\$1,542
\$1,000,000 and over.....	-\$15,871	-\$16,349	-\$16,160	-\$16,851	\$907
Total, All Taxpayers.....	-\$180,100	-\$164,973	-\$163,368	-\$165,729	\$59,526

Distribution of Business Tax Side of the Proposal

INCOME CATEGORY	CHANGE IN FEDERAL TAXES (\$ millions)				
	2019	2021	2023	2025	2027
Less than \$10,000.....	-\$269	-\$148	\$121	\$146	-\$92
\$10,000 to \$20,000.....	-\$586	-\$256	\$400	\$388	-\$257
\$20,000 to \$30,000.....	-\$703	-\$444	\$247	\$287	-\$644
\$30,000 to \$40,000.....	-\$947	-\$621	\$236	\$299	-\$855
\$40,000 to \$50,000.....	-\$1,195	-\$866	\$214	\$314	-\$1,218
\$50,000 to \$75,000.....	-\$4,158	-\$2,989	\$549	\$895	-\$4,052
\$75,000 to \$100,000.....	-\$5,158	-\$3,609	\$582	\$978	-\$4,563
\$100,000 to \$200,000.....	-\$18,964	-\$13,325	\$1,959	\$3,394	-\$16,306
\$200,000 to \$500,000.....	-\$18,476	-\$12,789	\$2,795	\$3,975	-\$13,539
\$500,000 to \$1,000,000.....	-\$7,916	-\$5,411	\$1,825	\$2,222	-\$4,641
\$1,000,000 and over.....	-\$20,983	-\$13,496	\$6,328	\$7,251	-\$9,401
Total, All Taxpayers.....	-\$79,354	-\$53,954	\$15,255	\$20,148	-\$55,569

Distribution of the Proposal

INCOME CATEGORY	CHANGE IN FEDERAL TAXES (\$ millions)				
	2019	2021	2023	2025	2027
Less than \$10,000.....	-\$396	-\$60	\$278	\$314	\$383
\$10,000 to \$20,000.....	-\$1,792	\$1,920	\$3,044	\$2,847	\$6,487
\$20,000 to \$30,000.....	-\$2,982	\$1,948	\$2,416	\$2,980	\$8,359
\$30,000 to \$40,000.....	-\$5,416	-\$1,956	-\$202	\$105	\$4,864
\$40,000 to \$50,000.....	-\$6,728	-\$3,522	-\$2,127	-\$1,701	\$4,317
\$50,000 to \$75,000.....	-\$23,046	-\$18,819	-\$14,944	-\$14,349	\$4,060
\$75,000 to \$100,000.....	-\$22,437	-\$20,583	-\$16,558	-\$16,652	-\$1,037
\$100,000 to \$200,000.....	-\$70,372	-\$64,835	-\$49,535	-\$48,439	-\$5,993
\$200,000 to \$500,000.....	-\$65,485	-\$61,510	-\$46,640	-\$47,460	-\$5,890
\$500,000 to \$1,000,000.....	-\$23,947	-\$21,661	-\$14,015	-\$13,623	-\$3,099
\$1,000,000 and over.....	-\$36,853	-\$29,845	-\$9,833	-\$9,600	-\$8,495
Total, All Taxpayers.....	-\$259,454	-\$218,927	-\$148,113	-\$145,581	\$3,958

Source: Joint Committee on Taxation

NUMBER OF RETURNS BY INCOME CLASS

INCOME CATEGORY (2)	NUMBER OF TAXPAYER UNITS (thousands) (1)					
	2019	2021	2023	2025	2027	
Less than \$10,000.....	19,260	19,286	19,053	19,034	18,985	
\$10,000 to \$20,000.....	20,566	20,755	20,726	20,681	20,378	
\$20,000 to \$30,000.....	21,510	21,700	21,965	22,183	22,499	
\$30,000 to \$40,000.....	16,011	15,920	15,903	15,951	16,263	
\$40,000 to \$50,000.....	12,841	13,239	13,707	14,004	14,365	
\$50,000 to \$75,000.....	27,393	27,575	27,986	28,396	28,651	
\$75,000 to \$100,000.....	17,835	18,190	18,670	19,033	19,489	
\$100,000 to \$200,000.....	30,667	31,169	31,869	32,622	33,332	
\$200,000 to \$500,000.....	9,152	9,431	9,542	9,765	9,923	
\$500,000 to \$1,000,000.....	1,147	1,180	1,186	1,206	1,215	
\$1,000,000 and over.....	572	584	594	611	629	
Total, All Taxpayers.....	176,955	179,029	181,201	183,485	185,726	

Source: Joint Committee on Taxation

(1) Includes nonfilers, excludes dependent filers and returns with negative income.
(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, [8] individual share of business taxes, and [9] excluded income of U.S. citizens living abroad. Categories are measured at 2017 levels.

**MACROECONOMIC ANALYSIS OF THE CONFERENCE AGREEMENT
FOR H.R. 1, THE “TAX CUTS AND JOBS ACT”**

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



December 22, 2017
JCX-69-17

INTRODUCTION

Pursuant to section 5107 of the Concurrent Resolution on the Budget for Fiscal Year 2018 and House Rule XIII(8)(b), this document,¹ prepared by the staff of the Joint Committee on Taxation (“Joint Committee staff”), provides an analysis of the macroeconomic effects of the Conference Agreement for H.R. 1, the “Tax Cuts and Jobs Act.”²

¹ This document may be cited as follows: Joint Committee on Taxation, *Macroeconomic Analysis of the Conference Agreement for H.R. 1, the “Tax Cuts and Jobs Act”* (JCX-69-17), December 22, 2017. This document can also be found on the Joint Committee on Taxation website at www.jct.gov.

² H.R. 1 as enacted by the House of Representatives and the Senate differs from the Conference Agreement in that it dropped three items with a combined total ten-year revenue effect of less than \$100 million.

MACROECONOMIC ANALYSIS OF THE CONFERENCE AGREEMENT FOR H.R. 1

This report provides an analysis of the macroeconomic effects of a proposal to reform the Internal Revenue Code (“Code”). Specifically, the proposal analyzed here is the one summarized in JCX-67-17, *Estimated Budget Effects of the conference Agreement for H.R. 1, the “Tax Cuts and Jobs Act.”* The Joint Committee staff estimates that this proposal would increase the average level of output (as measured by Gross Domestic Product (“GDP”) by about 0.7 percent relative to average level of output in the present law baseline over the 10-year budget window. That increase in output would increase revenues, relative to the conventional estimate of a loss of \$1,456 billion over that period by about \$451 billion. This budget effect would be partially offset by an increase in interest payments on the Federal debt of about \$66 billion over the budget period. We expect that both an increase in GDP and resulting additional revenues would continue in the second decade after enactment, although at a lower level, as many of the provisions that are expected to increase GDP within the budget window expire before the second decade.

The following discussion analyzes the macroeconomic effects of the bill. The estimate of the macroeconomic revenue feedback effects of this legislation and the following supplementary analysis were produced using three macroeconomic simulation models to simulate the growth effects of the bill: (1) the Joint Committee staff’s Macroeconomic Equilibrium Growth (“MEG”)³ model; (2) an overlapping generations model (“OLG”);⁴ and (3) the Joint Committee staff’s dynamic stochastic general equilibrium model (“DSGE”).⁵ A brief description of the models and the parameter values for each used in this analysis appear in the Appendix to this document. This analysis is presented relative to the 2017 economic and receipts baseline (“present law”) published by the Congressional Budget Office (“CBO”) in January, 2017.⁶

³ A detailed description of the MEG model may be found in Joint Committee on Taxation, *Macroeconomic Analysis of Various Proposals to Provide \$500 Billion in Tax Relief* (JCX-4-05), March 1, 2005, and Joint Committee on Taxation, *Overview of the Work of the Staff of the Joint Committee on Taxation to Model the Macroeconomic Effects of Proposes Tax Legislation to Comply with House Rule XIII(h)(2)* (JCX-105-03), December 22, 2003.

⁴ The OLG model currently used by JCT is leased from Tax Policy Advisors, LLC. Information about this model may be found in John W. Diamond and George R. Zodrow, *Modeling U.S. and Foreign Multinationals in an OLG-CGE Model*, Baker Institute for Public Policy, Rice University, working paper, 2015; and in G.R. Zodrow and J.W. Diamond, “Dynamic Overlapping Generations Computable General Equilibrium Model and the Analysis of Tax Policy: the Diamond-Zodrow Model,” in P.B. Dixon and D.W. Jorgenson (eds.) *Handbook of Computable General Equilibrium Modeling*, vol. 1A, pp. 743-813, North-Holland, 2013.

⁵ A description of an earlier version of the DSGE model may be found in Joint Committee on Taxation, *Background Information about the Dynamic Stochastic General Equilibrium Model Used by the Staff of the Joint Committee on Taxation in the Macroeconomic Analysis of Tax Policy* (JCX-52-06), December 14, 2006. An updated document, which describes modeling improvements, is forthcoming.

⁶ Congressional Budget Office, *The Budget and Economic Outlook: 2017-2027*, January 24, 2017.

Proposal

The bill changes individual income tax rates, lowering the top individual income tax rate from 39.6 percent to 37 percent, and lowering statutory tax rates for most of the remaining tax rate brackets, while changing some of the income levels associated with each bracket, and changing the measure used to adjust the brackets for inflation from the present law consumer price index (“CPI-U”) to the chained consumer price index (“chained CPI”). The chained CPI grows more slowly than the CPI-U, thus resulting in taxpayers over time moving into higher rate brackets at a faster rate under the bill than under present law. The bill also reduces to zero the individual shared responsibility payments for failure to obtain qualified health insurance coverage enacted as part of the Affordable Care Act to zero. At the same time, the proposal eliminates a number of deductions and credits from individual taxable income while increasing others. The biggest changes include eliminating personal exemptions while increasing the standard deduction, and increasing the maximum amount of the child tax credit while increasing the income range over which individuals may claim it. Finally, the bill generally doubles the exemption amount for the Estate, Gift, and Generation Skipping Transfer tax. Except for the switch from CPI-U to chained CPI for indexing tax brackets, changes in the tax treatment of alimony, and setting the ACA individual shared responsibility payments to zero, all of these changes to the taxation of individuals sunset after December 31, 2025.

The bill also makes substantial changes to the taxation of business income. Individuals receiving income from certain pass-through businesses may deduct 20 percent of that income from their individual income tax; like most of the other provisions affecting individual income tax filers, this deduction would sunset after 2025. In addition, the bill lowers the corporate income tax rate from 35 percent to 21 percent beginning in 2018; and, increases the rate of bonus depreciation to 100 percent in 2018, extending it for five years, from 2018 through 2022, and then phasing it out by the end of 2026. The bill also repeals or limits deductions for a number of business expenses, the largest of which are a 30 percent limit on interest deductibility and denial of carryback treatment of the net operating loss deduction. Finally, the bill makes significant changes to the taxation of both foreign and domestically controlled multinational entities. It would allow domestic corporations to receive a dividend from their foreign subsidiaries without incurring U.S. tax on the income, effectively switching the U.S. corporate tax from a worldwide to a territorial system. In order to reduce the erosion of the U.S. corporate income tax base, the bill equalizes the tax treatment of high return income from foreign sales whether they are earned through a foreign corporation or a domestic corporation, and imposes a new minimum tax for certain related party transactions.

Overall, the net effect of the changes to the individual income tax is to reduce average tax rates on wage income by about one percentage point, while reducing effective marginal tax rates on wages by about 2.5 percentage points until the expiration of the individual income tax provisions. The changes in the taxation of income from capital, the extension and expansion of bonus depreciation, and the reduction in tax rates on business income (both for corporations and for pass-through businesses) result in a reduction in the after-tax cost of capital investment, and thus an increase in the after-tax rate of return on business investment. This incentive begins to

decline toward the end of the 10-year budget period because of the phase-out of 100 percent bonus expensing and the expiration of the extra deduction for pass-through income, and because interest rates begin to rise as Federal debt increases due to the proposal.

Effects on output

The Joint Committee staff estimates that the proposal would increase the level of GDP relative to the baseline forecast, by 0.7 percent on average throughout the ten-year budget window. In general, tax policy affects economic growth by changing incentives for owners of capital to invest, and for potential workers to supply labor to the economy, by changing the after-tax rates of return to these two factors of production. Changes in tax policy can alter these after-tax rates of return - either directly by changing the amount of payments going to taxes, or indirectly, by changing aggregate demand, which can change gross payments for output. The projected increase in GDP during the budget window results both from an increase in labor supply, in response to the reduction in effective marginal tax rates on wages throughout most of the budget window, and from an increase in investment in response to the reduction in the after-tax cost of capital. Because of the expiration of individual income tax rate cuts and other provisions affecting wage taxation after 2025, the increase in labor supply is expected to decline, and possibly reverse, after 2025. Similarly, the phasing out of bonus depreciation and the special deduction for pass-through income are expected to slow the rate of new investment toward the end of the budget window. As a result, the increase in output reported above is expected to be in the range of 0.8 to 0.9 percent over most of the ten-year budget window, and fall to 0.1 to 0.2 percent by the end of the budget window.

Effects on capital stock

The amount of capital available for production is expected to be about 0.9 percent higher on average over the budget window than in the baseline forecast. During the budget window, increased investment primarily due to the reduction in the corporate tax rate, the five-year extension of bonus depreciation at 100 percent with an additional phase-out period, and the added tax deduction for certain pass-through business income results in a gradual accumulation of capital stock, which is forecast to reach its peak toward the end of the budget period. Somewhat offsetting this effect in the second half of the budget period is the effect of the growing deficit on interest rates, as well as the phase-out of bonus depreciation and the expiration of the extra deduction for certain pass-through income.

Effects on employment and supply of labor

The significant reduction in marginal tax rates on labor (resulting primarily from the additional tax rate bracket, lower statutory rates for most brackets, and the increase in the child credit) provide strong incentives for an increase in labor supply. Because the reduction in marginal tax rates on wages is reversed at the end of the budget window, after most of the changes to taxation of individual income have sunset, the timing and strength of the labor supply response varies significantly depending on how much foresight individuals are assumed to have about the future path of marginal tax rates. The more foresight individuals are assumed to have, the more they are forecast to shift their labor effort into the timeframe when marginal tax rates

are temporarily low. On average, employment is projected to increase by about 0.6 percent relative to baseline levels during the budget period. After the sunset of the individual tax provisions, the increase in employment is expected to decline.

Effects on consumption

The additional income generated by additional capital and labor - combined with the decreased tax liability owing to the proposal - provide individuals with more disposable income, thus increasing consumption. We estimate that consumption would be increased by 0.7 percent on average during the budget window, relative to baseline levels of consumption.

Effects of the estate and generation skipping transfer tax

Evidence from economic empirical and theoretical research on the effects of the estate and generation skipping transfer tax (referred to here as “estate tax”) on economic growth is very mixed. On the one hand, to the extent that an individual’s labor effort and investment behavior is driven by a desire to maximize the amount of wealth to be left to heirs, an increase in the exemption level of the estate tax would increase the marginal value to him of providing these additional resources to the economy; if this were the only behavioral response to the estate tax, the higher exemption would be expected to increase growth. However, it is also possible that individuals subject to the estate tax desire to leave a specific dollar amount to their heirs; in this case, the increased exemption from the tax would allow them to reach that target amount more quickly, thus reducing their incentive to work and invest. In addition, to the extent that the higher exemption increases the amount of income received by heirs, this could reduce the labor supply and savings of the heirs, thus reducing the amount of growth in the economy. Because of the uncertainty associated with the effects of the estate tax on growth from labor and investment incentives, changes in the estate tax are incorporated in Joint Committee staff macro models as changes in the average tax rate on individual income, and as having no effect on marginal tax rates, which are the main drivers of behavioral response in Joint Committee staff macroeconomic models. Thus, the effects of the increased exemption from the estate tax are primarily a small increase in consumption, and a negligible change in GDP and other macroeconomic aggregates.⁷

Effects of changes in the treatment of income from foreign activity

The proposal changes the taxation of both foreign and domestically controlled multinational corporations in order to limit erosion of the corporate income tax base.

To some extent, under present law, base erosion occurs because firms are able to attribute their profits to low-tax countries and their costs to the United States without changing the location of their economic activity. The proposals affecting taxation of foreign activity are expected to reduce the incentives for this “profit-shifting” activity, thus resulting in an increase in the U.S. tax base. The conventional revenue estimates for these provisions include the effects

⁷ For a brief discussion on ramifications of estate taxation, see Joint Committee on Taxation, *The Taxation of Individuals and Families* (JCX-41-17), September 12, 2017, pp. 47-48, and for additional data and a more detailed discussion of economic issues, see Joint Committee on Taxation, *History, Present Law, and Analysis of the Federal Wealth Transfer Tax System* (JCX-52-15), March 16, 2015, pp. 24-46.

of reducing profit shifting. The effects of these types of provisions on incentives to locate economic activity in the United States are included in the macroeconomic analysis and feedback estimate. The macroeconomic estimate projects an increase in investment in the United States, both as a result of the proposals directly affecting taxation of foreign source income of U.S. multi-national corporations, and from the reduction in the after-tax cost of capital in the United States due to more general reductions in taxes on business income.

Budgetary effects

Fiscal years 2018-2027

The growth generated by the proposal is projected to reduce the revenue loss from the proposal by about \$451 billion over the 2018-2027 budget period. At the same time, an increase in interest rates generated by the increase in Federal debt is expected to increase the cost of Federal debt service by about \$66 billion over the budget window. Overall, the budgetary effects of changes in economic growth are projected to reduce the deficit by \$385 billion during the budget window.⁸ Details of the estimate appear on Table 1, following.

The estimate of the impact of the growth effects from this proposal on its overall budget effects was produced using a weighted average of those effects generated by the MEG, OLG, and DSGE models. The OLG and MEG models are each assigned a weight of 0.4, while DSGE is assigned a weight of 0.2. As described in the Appendix, each model provides a somewhat different perspective on savings/investment responses and international capital flows. The OLG model provides some focus on shifting of investment between domestic and multinational corporations, as well as within multinational corporations across borders, but requires a fiscal balance assumption. The MEG model allows simulation of the proposal as drafted, with no offsetting fiscal balance assumption, and it models cross-border capital flows that can partially offset the effects of a growing deficit on interest rates. The DSGE model is included because, although it does not model cross-border flows, it does model separate investment responses by savers and non-savers. It also adds imperfect foresight to the analysis, an assumption sitting between the perfect foresight assumption of the OLG model and the myopic foresight in the MEG model. The foresight assumption is particularly important for analyzing the effects of temporary provisions.

Second and third decade effects

In the second decade after enactment, the direct tax incentives for increased labor effort that contributed to the projected increase in GDP during the 10-year budget window are reversed, with the continuing effect of indexing tax brackets by chained CPI of moving people to higher tax brackets more quickly than they would be moved under present law. The combination of increased revenues due to chained CPI and continuing savings due to reducing individual shared responsibility payment amounts to zero slow the growth of the deficit in the second and

⁸ The extension of bonus depreciation in the bill is an important contributor to increased investment incentives created by the bill. Because of the more generous deduction created for new investment by this provision, the increased investment reduces the taxable base during the time period when this provision is in force, thus reducing the amount of revenue feedback associated with the increase in GDP.

third decades. However, the continuation of chained CPI provision coupled with the sunset of most other individual provisions result in an increased marginal tax rate on labor, dampening labor supply incentives, and reducing the increase in GDP relative to projected baseline levels. The permanent reduction in the corporate income tax rate continues to provide an incentive for maintenance of a higher capital stock (relative to baseline levels) and GDP in the second decade; but the increase in debt created during the budget period is expected to continue to exert some upward pressure on interest rates. Combined with reduced labor supply due to increasing tax rates on labor, the upward pressure on interest rates is projected to partially or wholly offset capital accumulation incentives by the end of the third decade.

- TABLE 1 -
**ESTIMATED BUDGET EFFECTS OF THE
CONFERENCE AGREEMENT FOR H.R.1**
Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Conventional estimate.....	-135.7	-280.0	-258.8	-220.8	-178.3	-137.9	-120.1	-114.6	-40.6	32.9	-1074.0	-1,456.0
Additional Effects Resulting from Macroeconomic Analysis	32.2	34.4	36.6	38.5	37.0	40.5	46.5	47.8	35.5	35.5	178.8	384.6
NET TOTAL	-103.5	-245.6	-222.2	-182.3	-141.3	-97.4	-73.6	-66.8	-5.1	68.4	-895.2	-1071.4
..... Joint Committee on Taxation												

NOTE: Details may not add to totals due to rounding

APPENDIX: DATA, MODELS, AND ASSUMPTIONS USED IN THE ANALYSIS

The Joint Committee staff analyzed the proposal using the Joint Committee staff MEG and DSGE models and an OLG model. While the models are based on economic data from the National Income and Product Accounts, taxable income is adjusted to reflect taxable income as measured by reporting on tax returns. All three models start with the standard, neoclassical production framework in which the amount of output is determined by the quantity of labor and capital used by firms, and the productivity of those factors of production; long run aggregate demand equals aggregate supply at full employment. Both individuals and firms are assumed to make decisions based on observed characteristics of the economy, including wages, prices, interest rates, tax rates, and government spending levels. In particular, the amount of labor available to the economy is affected by individuals' understanding of their after-tax returns to working, which depends on both wage rates and tax rates. Similarly, the amount of capital available to the economy is determined by investors' predictions of after-tax returns to capital, which depend on anticipated gross receipts, costs of factor inputs, and tax rates that affect those factors. The underlying structure of the MEG model relies more on reduced form behavioral response equations, while the OLG and DSGE models incorporate more theoretical microeconomic foundations.

The degree to which the Joint Committee staff relies more heavily on the results of one model versus the others depends on the specifics of the proposal being analyzed. The MEG model, which does not require a fiscal balance assumption, is better suited to analyze proposals that produce large, conventionally estimated deficits. This model allows for the modeling of four separate types of labor, and of separate marginal and average tax rates for all major individual and business income tax sources; while the other two models treat average and marginal rates the same for individual income other than wages. The availability of investment capital to firms is determined by individuals' savings response to changes in the after-tax rate of return on investment as well as by foreign capital flows. Also in the MEG and DSGE models, monetary policy conducted by the Federal Reserve Board is explicitly modeled, with delayed price adjustments to changes in economic conditions allowing for the economy to be temporarily out of equilibrium in response to fiscal and monetary policy. The monetary policy response function used in this analysis assumes that the Fed will act aggressively to counteract any demand stimulus resulting from the proposal because the economy is expected to be operating near full employment. The myopic expectation framework in the MEG model represents the extreme case of the degree of foresight individuals have about future economic conditions, in which individuals assume in each period that current economic conditions will persist permanently.

At the other end of the foresight spectrum, in the OLG model, individuals are assumed to make consumption and labor supply decisions to maximize their lifetime well-being given the resources they can foresee will be available to them. They are assumed to have complete information, or "perfect foresight," about economic conditions, such as wages, prices, interest rates, tax rates, and government spending, over their lifetimes. OLG represents a class of models with "micro-foundations" and life-cycle effects modeled separately for each of a number of "generations" (in this case 55). Taxes on labor affect the decisions of each cohort by impacting

the trade-off between consumption and leisure. Individuals substitute between labor and leisure both contemporaneously and over time. The OLG model includes a more differentiated business sector than the other two models. Firms' investment decisions respond to the effects of tax policy on the projected future value of the firm. Changes in marginal tax rates on firm profits, and changes in the value of deductions for investment affect this future valuation.

The stochastic feature of the DSGE model allows for some analysis of the effects of uncertainty about future fiscal policy on the modeling outcome, representing a less extreme foresight assumption than either of the other models. As the uncertainty about future fiscal conditions is allowed to persist over a limited period of time, DSGE is closer to OLG than to MEG on this spectrum. In DSGE there are two types of individuals who make decisions about labor supply, only one of whom has the liquidity to make investment decisions ("savers and non-savers"). As in the OLG model, these two types of individuals make consumption and labor supply decisions to maximize their discounted present value of consumption over time, including consumption of leisure. The savers supply investment capital to the economy, and receive income from investment returns. The non-savers are liquidity constrained, and are unable to invest. The existence of these two types of individuals allows for some explicit distributional analysis of taxes on investment versus taxes on labor. In addition, changes to transfers and taxes on the non-saving households will have direct effects on current period consumption and the current level of output. These features of the DSGE model allow the model to interpret real short run effects of economic policy changes.

In the OLG and DSGE models, the ability of individuals to foresee changes in fiscal conditions means that the agents in the models will be unable to make optimal economic decisions if they can foresee a permanently unstable economic future, thus preventing the models from "solving" - or completing their simulations. This problem arises in a situation where deficits are expected to increase faster than the rate of growth of GDP, which is a characteristic under present law as well as the bill. Thus it is necessary to make counter-factual "fiscal balance" assumptions about the expected path of deficits for these models.

In the baseline, the OLG model maintains a constant debt to GDP ratio primarily by reducing government purchases. For the proposal analyzed in this document, which is expected to increase the debt to GDP ratio, the OLG model simulates the policy as stipulated for 30 years, and adjusts transfer payments thereafter to stabilize the debt to GDP ratio.

Decision-makers in the DSGE model are able to foresee the consequences of the new policy in the bill with certainty for the first 2.5 years of the budget window. Each quarter after that, they assume there is some probability (which increases over time) that the debt-to-GDP ratio will stabilize, thus allowing the model to solve and the simulation to continue. At the same time, the actual policy is implemented through a series of shocks throughout the 10-year budget period. After 10 years, the model assumes the debt-to-GDP ratio returns to a steady state.

The 30-year delay in imposing fiscal balance in OLG and the uncertain expectations with respect to future fiscal conditions in DSGE reduce the impact of the models' respective fiscal balance assumptions on decisions made inside the budget window.

Each major tax bill potentially presents a unique combination of changes in the definition of the taxable base for different sources of income, as well as changes in tax rates on different sources of income. Each such combination of changes may present a different amount of macroeconomic revenue feedback relative to the change in GDP generated by the proposal. Because the Joint Committee staff uses these models to facilitate analysis of tax policy, and to estimate the revenue consequences of the macroeconomic effects of tax policy, the staff has devoted a considerable amount of time and attention to modeling the specific types of income flows affected by proposals, to the extent allowed by other sets of assumptions within each macroeconomic model. Information about the effects of the proposal on average tax rates and effective marginal tax rates on each source of income, and on after-tax returns to capital and labor, is obtained from various Joint Committee staff tax models⁹ (used in the production of conventional revenue estimates) to characterize the effects of the bill within the each of the models. Changes in deductions, credits and exclusions can impact effective marginal tax rates as well as average tax rates.

Tables 2-4 provide a summary of key behavioral parameters used in the each of the macroeconomic simulation models for the analysis of this proposal.

⁹ Descriptions of the Joint Committee staff’s conventional estimating models may be found in JCX-46-11, *Testimony of the Staff of the Joint Committee on Taxation before the House Committee on Ways and Means Regarding Economic Modeling*, September 21, 2011, JCX-75-15, *Estimating Changes in the Federal Individual Income tax: Description of the Individual Tax Model*, April 24, 2015, and other documents at www.jct.gov under “Estimating Methodology.”

Table 2: Key Parameter Assumptions in the MEG Model

Labor supply elasticities in disaggregated labor supply	Income	Substitution
Low income primary	-0.1	0.2
Other primary	-0.1	0.1
Low income secondary	-0.3	0.8
Other secondary	-0.2	0.6
Wage-weighted population average with baseline rates	-0.1	0.2
Savings/consumption parameters		
Rate of time preference		0.015
Intertemporal elasticity of substitution		0.35
Derived long-run savings elasticity to the after rate of return on capital		0.25

Table 3: Key Parameter Assumptions in the DSGE Model

Frisch elasticity of labor supply	0.20
Production income share of capital	36%
Fraction of savers	48%
Monetary authority response to inflation	1.55
Monetary authority response to output	0.05
Quarterly subjective discount factor	0.9975
Constant relative risk aversion parameter on utility from consumption	2.15
Intermediate firm markup	13%
Probability of price reset	50%

Table 4: Key Parameter Assumptions in the OLG Model

Time preference	0.005
Intertemporal elasticity of substitution	0.4
Intratemporal elasticity of substitution between consumption and leisure	0.6
Leisure share of time endowment	0.4026
Population growth rate	0.008
Technological growth rate	0.019
Capital share for:	
Corporate	0.2
Multinational (not including IP)	0.15
Non-corporate	0.3
Housing	0.985
Adjustment cost*	2.0
Debt-to-capital ratio (average)	0.35
Substitution elasticity between capital and labor in	
Non-housing**	1.0
Housing**	1.0
Substitution elasticity for intellectual property****	1.0

* Quadratic adjustment cost function

** Cobb-Douglas production function

*** Substitution elasticity between foreign and domestic after- tax profits attributable to intellectual property

Appendix D: KPMG List of new or revised procedural items in the new tax law

New or Amended Penalties

1. Regarding new section 199A, adds new Section 6662(d)(1)(C) Special Rule for Taxpayers Claiming Section 199A Deduction, to reduce the section 6662(d)(1)(A) substantial underpayment penalty to 5% from 10%. (pg. 17 H.R. 1)
2. Amends section 6695(g) to expand Failure to Be Diligent tax return preparer penalty (\$500/failure) to lack of due diligence in determining the eligibility to file as a head of household on a return. (pg. 5 H.R. 1)
3. Adds new subsection 6652(p), Failure to Provide Notice Under Section 83(i), with respect to the new section 83(i)(6) notice— unless failure is due to reasonable cause and not willful neglect—\$100 for each failure with a calendar year maximum of \$50,000 for all failures. (pg. 111 H.R. 1)
4. New Section 1400Z-2, Special Rules for Capital gains Invested in Opportunity Zones, provides an election, and limits to that election, to defer income on certain capital gains. Subsection (f) provides a formulaic penalty for the failure of a qualified opportunity fund to maintain the investment standard required by the new section. The penalty can be avoided if “it is shown such failure is due to reasonable cause.” (pg. 135 H.R. 1)
5. The Section 6038A penalty is increased to \$25,000 from \$10,000. (pg. 180 H.R. 1)

New Elections

1. Temporary 100% Expensing. Adds new Section 168(k)(10) Special Rule for Property Placed in Service During Certain Periods— applies to qualified property placed in service by a taxpayer during the first taxable year ENDING after September 27, 2017, and allows an election to have the new rules apply to this taxable year at an applicable percentage of 50% (it is 100% for qualified property placed in service after September 27, 2017). This election “shall be made at such time and in such form and manner as the Secretary may prescribe.” (pg. 54-55 H.R. 1)
2. Accounting Methods. New Section 451(c) Treatment of Advance Payments. Generally

advance payments to be included in gross income in year of receipt, but election allows some to be included in gross income of following year. This election “shall be made at such time, in such form and manner, and with respect to such categories of advance payments, as the Secretary may provide” and is effective for the year of election and all subsequent elections, unless the taxpayer obtains consent to revoke. This election shall not apply to advance payments received during a taxable year if such taxpayer ceases to exist during that taxable year (except as otherwise provided by the Secretary). (pg. 62-63 H.R. 1)

3. Limitation on Deduction for Interest. Amends section 163(j) Limitation on Business Interest, and new 163(j)(7)(B) and (C) provide for a business to be an “Electing Real Property Business” or an “Electing Farming Business.” “Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.” (pg. 67 H.R. 1)
4. NOL Deduction Modification. Section 172(b) (1), as otherwise amended and after striking current section 172(b)(1)(B) through (F), adds new section 172(b)(1)(B) Farming Losses, which allows an eligible taxpayer to forego the new 2 year carryback. “Such election shall be made in such manner as prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer’s return for the taxable year of the net operating loss.” Such election is irrevocable. (pg. 69 H.R. 1)
5. Modification of the Orphan Drug Credit. Amends Section 280C to add new section 280C(b)(3) (current 280C(b)(3) is re-designated 280C(b)(4)) which allows an election of a reduced credit. This election “shall be made not later than the time for filing the return of tax for such year (including extensions) shall be made on such return, and shall be made in such manner as the Secretary shall prescribe.” This election is irrevocable. (pg. 80-81 H.R. 1)
6. New Section 45S, Employer Credit for Paid Family and Medical Leave. Section 45S(h) Election to Have Credit Not Apply. “A taxpayer

- may elect to have this section not apply for any taxable year. Rules similar to the rules of paragraphs (2) and (3) of section 51(j) shall apply for purposes of this subsection. (pg. 84 H.R. 1)
7. REPEALED the Historical Payment Pattern Election provided by current Section 846(e) (Discounted Unpaid Losses), striking that subsection. (pg. 99 H.R. 1)
 8. Amended Section 83 to add new subsection 83(i) Qualified Equity Grants. Allows a “qualified employee” who is transferred “qualified stock” to make an election regarding the timing of income inclusion related to such qualified stock transfer. Section 83(i)(4)(A) Time for Making Election—“An election...shall be made...no later than 30 days after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under subsection (b).” (pg. 108-109 H.R. 1)
 9. New Section 247, Contributions to Alaska Native Settlement Trusts, allowing a deduction for contributions made by a Native Corporation to a Settlement Trust...for which the Native Corporation has made an annual election under subsection (e). Subsection (e) provides an election “for each taxable year...on the income tax return or an amendment or supplement to the return...with such election to have effect solely for such taxable return.” It also provides the election “may be revoked pursuant to a timely filed amendment or supplement to the income tax return...” (pg. 126 H.R. 1) NOTE: The Effective Date provision allows new section 247 to apply to all “open” years, i.e., where the refund statute has not expired, AND provides that if the refund statute for a year “expires before the end of the 1-year period beginning on the date of the enactment of the Act,” the refund may still be paid if a claim for refund is filed before the close of this 1-year period. (pg. 128 H.R. 1)
 10. New Section 247, Contributions to Alaska Native Settlement Trusts, adding subsection (g) Election by Settlement Trust to Defer Income Recognition—this election applies to contributions “of property other than cash” allowing a “Settlement Trust may elect to defer recognition of any income related to such property until the sale or exchange of such property, in whole or in part.” Subsection (g) (3) provides an election with rules similar to 9 above, with the Settlement Trust identifying and describing the property with reasonable particularity on the Settlement Trust’s return. (pg. 127 H.R. 1) NOTE: The Effective Date provision allows new section 247 to apply to all “open” years, i.e., where the refund statute has not expired, AND provides that if the refund statute for a year “expires before the end of the 1-year period beginning on the date of the enactment of the Act,” the refund may still be paid if a claim for refund is filed before the close of this 1-year period. (pg. 128 H.R. 1)
 11. New Section 1400Z-2, Special Rules for Capital gains Invested in Opportunity Zones, provides an election, and limits to that election, to defer income on certain capital gains. (pg. 131 and 135 H.R. 1)
 12. Amended Section 965(h), Election to Pay Liability in Installments, provides a US shareholder taxpayer the ability to elect paying the “net tax liability” in 8 installments.
 - a. Section 965(h)(5) provides that this election “shall be made not later than the due date for the return of tax for the taxable year [THE CFC’s 5471–verify] described in subsection (a) and shall be made in such manner as the Secretary shall prescribe.” (pg. 149-150 H.R. 1)
 - b. There are special election rules for S corporation shareholders in section 965(i), (pg. 151-152 H.R. 1),
 - c. There are special election rules for US shareholders who are REITs in section 965(m)(2), (pg. 153 H.R. 1)
 - d. Section 965(n), Election Not to Apply NOL Deduction, provides an election to calculate NOLs without taking into account the Amount Described in that subsection. “Any election under this subsection shall be made not later than the due date (including extensions) for filing the return of tax for the taxable year and shall be made in such manner as the Secretary shall prescribe.” (pg. 154 H.R. 1)
 13. Amended Section 904 to add new subparagraph 904(g)(5), Election to Increase Percentage of Taxable Income Treated as Foreign Source. (pg. 173 H.R. 1)

Corporation AMT Repeal--Sequestration

1. Amended Section 53 to add section 53(e) Portion of Credit Treated as Refundable, to provide a process to allow corporations to claim their remaining credits from 2018-2021. It is highly likely that as these credits are refundable, sequestration reductions still apply. (pg. 41 H.R. 1)

New Information Reporting, Withholding, or Notice Requirements

1. New Section 6050X, Information with Respect to Certain Fines, Penalties, and Other Amounts. Related to amended section 162(f) to provide denial of deductions for certain fines, penalties, and other amounts. The "appropriate official of any government or any [section 162(f)(5) nongovernmental entity] which is involved in a suit or agreement described in paragraph (2) shall make a return in such form as determined by the Secretary setting forth [the information that follows]." "The return...shall be filed at the time the agreement is entered into, as determined by the Secretary," and a written statement shall also be provided to each person who is a party to the suit or agreement at the same time. (pg. 75-76 H.R. 1)
2. New Section 1446(f) (current 1446(f) re-designated as 1446(g)) Special Rules for Withholding on Dispositions of Partnership Interests (related to new section 864(c)(8) Gain or Loss of Foreign Persons from Sale or Exchange of Certain Partnership Interests. The transferee "shall be required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition" unless a "nonforeign affidavit" is furnished. (pg. 86-87 H.R. 1)
3. Section 807 Computation of Life Insurance Tax Reserves. Amends Section 807(e) to add new section 807(e)(6) (current (e)(6) is re-designated as (e)(4)) "6) Reporting Rules—The Secretary shall require reporting (at such time and in such manner as the Secretary shall prescribe) with respect to the opening balance and closing balance of reserves and with respect to the method of computing reserves for purposes of determining income." (pg. 93 H.R. 1)
4. Tax Reporting for Life Settlement Transactions. New Section 6050Y, Returns Relating to certain Life Insurance Contract Transactions. There are multiple reporting requirements added by section 6050Y. (a)(1) In General— Every person who acquires a life insurance contract or any interest in a life insurance contract in a reportable policy sale during any taxable year shall make a return for such taxable year (at such time and in such manner as the Secretary shall prescribe), setting forth..." Also requires furnishing written statements "to persons with respect to whom information is required." (b)(1) requires reporting of the seller's basis, with a corresponding requirement to furnish written statements "to persons with respect to whom information is required." (c)(1) requires reporting of reportable death benefits, with a corresponding requirement to furnish written statements "to persons with respect to whom information is required." (pg. 96-97 H.R. 1)
5. Amended Section 83 to add new subsection 83(i) Qualified Equity Grants, which adds new section 83(i)(6), Notice Requirement, requiring a corporation that transfers qualified stock to a qualified employee to provide a notice to such employee certifying the stock is qualified stock and of the new option to elect to defer income related to that stock. (pg. 110 H.R. 1)
6. Adds new subsection 3402(t), Amount of Withholding (with respect to Qualified Stock for Which an Election is in Effect Under Section 83(i)—the rate shall be not less than the maximum section 1 rate, and qualified stock shall be treated for section 3501(b) purposes as a non-cash fringe benefit. (pg. 110 H.R. 1)
7. Adds new subsection 6039H(e) requires a Native Corporation that makes a contribution to a Settlement Trust covered by new section 247 to provide a statement to the Settlement Trust not later than January 31 of the calendar year following the calendar year the contribution was made. (pg. 128-129 H.R. 1)
8. Amends Section 6038A(b) to clarify existing (b) and add additional information regarding base erosion payments, i.e., "(A) such information as the Secretary determines necessary to determine the base erosion minimum tax amount, base erosion payments, and base erosion tax benefits of the taxpayer for purposes of Section 59A for the taxable year, and (B) such other information as the Secretary determines necessary to carry out such section." (pg. 180 H.R. 1)

Miscellaneous Items

1. Levies. Amended Sections 6343(b) and 6532(c) to provide 2 years (instead of 9 months) to seek the return of property levied by IRS and for non-taxpayers to bring a suit regarding a levy under section 7426. Applies to levies made after date of enactment of H.R. 1 AND to levies made prior to enactment if the original 9 month period under section 6343(b) had not expired by the date of enactment. (pg. 38-39 H.R. 1)
2. Small Business Accounting Method Reform and Simplification (sections 448(c) Cash Method, 447(f) Farming, 263A UNICAP, 471(c) Inventories, and 460(e) Exemption from Percentage Completion Long Term Contracts). Provides that any change in method of accounting made pursuant to the changes provided by the law "shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary." (pg.s 49 (448(c)), 50 (447(f) and 263A UNICAP), 51 (471(c) and 460(e)), H.R. 1)
3. Amortization of R&E Expenditures (section 174). Amends section 174, and provides that the amendments to section 174(a) "shall be treated as initiated by the taxpayer...made with the consent of the Secretary, and ... applied only on a cut-off basis for any [R&E] expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments shall be made." (pg. 59 H.R. 1)
4. NOL – Differing Effective Date Provisions: The effective date for the repeal of the NOL carryback provision is not the same as the effective date of the new 80% NOL limitation provision. In general, the new law amended Section 172(b)(2) to repeal carrybacks of NOLs arising in taxable years ending on or after December 31, 2017, meaning that, for example, a corporation with a taxable year ending September 31, 2018 is not allowed to carry back an NOL arising in that taxable year. Pub. L. No. 115-97, Section 13302(e) (2). However, the legislative history indicates the carry back provision was intended to apply with respect to NOLs arising in taxable years beginning after December 31, 2017. See H. Conf. Rept. No. 115-466, at p. 394 (2017) (Statement of Managers' description of Senate Amendment and Conference Agreement). It is unclear if or when a technical correction will be pursued. The new law also amended Section 172(a) to limit the NOL deduction for a given year to 80% of taxable income with respect to NOLs arising in tax years beginning after December 31, 2017. Pub. L. No. 115-97, Section 13302(e)(1). The new law requires taxpayers to separately track NOLs arising in tax years beginning (1) on or before December 31, 2017, and (2) after December 31, 2017, because only NOLs arising in tax years beginning after December 31, 2017 are subject to the 80% limitation.
5. Amended Section 965(k) Extension of Limitation on Assessment, provides a 6 year period to assess the "net tax liability, running from the date the return for the taxable year described in subsection (h)(6) was filed. (pg. 152 H.R. 1)
6. Amended Section 958(b), changing the stock attribution rules for determining whether a foreign corporation is a CFC and whether a US person is treated as a US shareholder of the CFC for US federal income tax purposes. This likely has an immediate effect on US corporations for CFCs with calendar year ends and may result in expanded requirements to file Forms 5471. (pg. 164-165 H.R. 1)

Secretary Regulatory Authority

1. New Section 199A(b)(5)—"The Secretary shall provide for the application of this subsection in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year." (pg. 12 H.R. 1)
2. New Section 199A(f)(1)(A)(iii) (Special Rules [application to partnerships and S corporations])—"...each partner shall be treated for purposes of subsection (b) as having W-2 wages and unadjusted basis..." (as determined under regulations prescribed by the Secretary)." (pg. 15 H.R. 1)
3. New Section 199A(f)(4) Regulations—"The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations..." [for restricting allocations/wages, and such reporting requirements and the Secretary determines appropriate, and for application in tiered entities.] (pg. 16 H.R. 1)

4. New Section 199A(h) Anti-Abuse Rules—“The Secretary shall (1) apply rules similar to the rules under section 179(d)(2)...and (2) prescribe rules for determining the unadjusted basis...in like-kind exchanges or involuntary conversions.” (pg. 17 H.R. 1)
5. Amended Section 461 to add 461(l)(5) Additional Reporting—“The Secretary shall prescribe such additional reporting requirements as the Secretary determines necessary to carry out the purposes of this of this subsection.” (pg. 19 H.R. 1)
6. Amended Section 3402(f)(1) and (2), regarding withholding exemptions/allowances, to read—“(1) In General—Under rules determined by the Secretary, an employee receiving wages shall on any day be entitled to a withholding allowance determined based on [6 factors]. (2) Allowance Certificates—“...the employee shall, in such cases and at such times as the Secretary shall by regulations prescribe, furnish the employer with a withholding allowance certificate...” (pg.s 30, 31 H.R. 1)
7. Amended Section 3405(a)(4) to read “...shall be determined under rules prescribed by the Secretary.” (pg. 31 H.R. 1)
8. Amended Section 2001(g) to include (g)(2) Modifications to Estate Tax Payable to Reflect Different Basic Exclusion Amounts—“The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to [section 2010(c) (3)’s basic exclusion amount and with respect to gifts made by decedent].” (pg. 38 H.R. 1)
9. Accounting Methods. New Section 451(c) Treatment of Advance Payments. “Except as otherwise provided by the Secretary, the election under [451(c)(1)(B)] shall not apply....” (pg. 62 H.R. 1)
10. Accounting Methods. New Section 451(c) Treatment of Advance Payments, definition of Advance Payments in section 451(c)(4). “(A) In General—... (iii) which is for goods, services, or such other items as may be identified by the Secretary for purposes of this clause,” and “(B) Exclusions—Except as otherwise provided by the Secretary, such term shall not include...” (pg. 63 H.R. 1)
11. Limitation on Deduction for Interest. Amends section 163(j) Limitation on Business Interest, and new 163(j)(8) provides the definition of Adjusted Taxable Income as “the taxable income of the taxpayer (A) computed without regard to [certain items] and (B) computed with such other adjustments as provided by the Secretary.” (pg. 67 H.R. 1)
12. New Section 1061, Partnership Interests Held in Connection with Performance of Services. Section 1061(b) Special Rule—“To the extent provided by the Secretary, subsection (a) shall not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors.” (pg. 77 H.R. 1)
13. New Section 1061, Partnership Interests Held in Connection with Performance of Services. Section 1061(e) and (f). “(e) Reporting—The Secretary shall require such reporting (at the time and in the manner prescribed by the Secretary) as is necessary to carry out the purposes of this section. (f) Regulations—The Secretary shall issue such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section.” (pg. 78 H.R. 1)
14. Amended Section 118 Contributions to the Capital of a Corporation, and addend new subsection “(c) Regulations—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out this section, including regulations or other guidance for determining whether any contribution constitutes a contribution in aid of construction.” (pg. 79 H.R. 1)
15. New Section 45S, Employer Credit for Paid Family and Medical Leave. Section 45S(f) Determinations Made by Secretary of Treasury—“...any determination...shall be made by the Secretary based on such information, to be provided by the employer, as the Secretary determines to be necessary and appropriate.” (pg. 84 H.R. 1)
16. New Section 864(c)(8) Gain or Loss of Foreign Persons from Sale or Exchange of Certain Partnership Interests. “(E) Secretarial Authority—The Secretary shall prescribe such regulations or other guidance as the Secretary determines appropriate for the application of this paragraph, including with respect to exchanges described in section 332, 351, 354, 355, 356, or 361.” (pg. 86 H.R. 1)
17. New Section 1446(f) (current 1446(f) re-designated as 1446(g)) Special Rules for Withholding on Dispositions of Partnership Interests (related to new section 864(c)(8))

- Gain or Loss of Foreign Persons from Sale or Exchange of Certain Partnership Interests. (pg. 87 H.R. 1)
- a. 1446(f)(2)(B) False Affidavit—the exception to deducting and withholding the 10% if a nonforeign affidavit is provided does not apply if transferee has actual knowledge or receives a notice from a transferor’s or transferee’s agent that the affidavit is false, or “the Secretary by regulations requires the transferee to furnish a copy of such affidavit or statement to the Secretary and the transferee false to furnish a copy of such affidavit or statement to the Secretary at such time and in such manner as required by such regulations.”
 - b. 1446(f)(6) Regulations—“The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this subsection, including regulations providing for exceptions from the provisions of this subsection.”
18. New Section 4960, Tax on Excess Tax-Exempt Organization Executive Compensation. Section 4960(d) Regulations—“The Secretary shall prescribe such regulations as may be necessary to prevent avoidance of the tax under this section, including regulations to prevent avoidance of such tax through the performance of services other than as an employee or by providing compensation through a pass-through or other entity to avoid such tax.” (pg. 106 H.R. 1)
 19. Craft Beverage Reform. Section 5051(a) is amended to add “(4) Reduced Tax Rate for Foreign Manufacturers—to assign the reduced tax rate to an “electing importer of such barrels pursuant to the requirements established under subparagraph (B). (B) Assignment—The Secretary shall, through rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the reduced tax rate provided under this paragraph, which shall include” [misc. guidance on the rules, as well as “requirements that the brewer provide any information as the Secretary determines appropriate for purposes of carrying out this paragraph...”]. (pg. 118 H.R. 1)
 20. Craft Beverage Reform. Section 5051(a) is amended to add new controlled group and single taxpayer rules, which provide for apportionment among group brewers “in such manner as the Secretary or their delegate shall by regulations prescribe.” This also provides a definition of the meaning of “controlled group” and then states “Under regulations prescribed by the Secretary, principles similar to the principles of the preceding two sentences shall be applied to a group of brewers under common control where one or more brewers is not a corporation.” (pg. 119 H.R. 1)
 21. Re transfer of beer between bonded facilities, amends Section 5414 by adding 5414(b), which allows transfers between and mingling of beer at bonded facilities “as the Secretary by regulations shall prescribe, which shall include” [various factors to consider]. (pg. 119 H.R. 1)
 22. Re reduced excise tax on wine, section 5041(c) is amended to allow credits similar to the craft beverage provisions with similar to 19 and 20 above. (pg. 120-121 H.R. 1)
 23. Re definition of “mead” wine, by adding subsection 5041(h) specifically regarding mead wine and establishing carbon dioxide tolerances (not more than 0.64 grams per 100 milliliters of wine) “except that the Secretary shall by regulations prescribe such tolerances to this limitation as may be reasonably necessary in good commercial practice.” (pg. 122 H.R. 1)
 24. Re reduce excise tax on distilled spirits, amends new subsection 5001(c) to reduce the rates, with provisions similar to 19 and 20 above. (pg. 123-124 H.R. 1)
 25. Adds new subsection 6039H(e) which in part provides a list of information required by the new Native Corporation statement under section 247, including “(E) such information as the Secretary determines to be necessary or appropriate for the identification of each contribution and the accurate inclusion of income relating to such contributions by the Settlement Trust.” (pg. 129 H.R. 1)
 26. New Section 1400Z-2, Special Rules for Capital gains Invested in Opportunity Zones, provides an election, and limits to that election, to defer income on certain capital gains. New subsection (e) provides some “Applicable Rules, and (e)(4) provides “Regulations—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of these section, including” [suggested areas for such regulations]. (pg. 135 H.R. 1)

27. New Section 245A, Deduction for Foreign Source-Portion of Dividends Received by Domestic Corporations from Specified 10-percent owned Foreign Corporations, includes section 245(g) Regulations—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including regulations for the treatment of US Shareholders owning stock of a specified 10 percent foreign corporation through a partnership.” (pg. 137 H.R. 1)
28. New Section 91 Certain Foreign Branch Losses Transferred to Specified 10-Percent Owned Foreign Corporations, includes section 91(e) Basis Adjustments—Consistent with such regulations or other guidance as the Secretary shall prescribe, proper adjustments shall be made in the adjusted basis of the taxpayer’s stock...” (pg. 141 H.R. 1)
29. Amended Section 965, Treatment of Deferred Foreign Income upon Transition to Participation Exemption System of Taxation contains a few grants to the Secretary to make rules.
- Section 965(c)(3)(B), regarding the definition of “Cash Position” (B)(iii)(V) includes “any asset which the Secretary identifies as being economically equivalent to any asset described in this subparagraph. (pg. 146 H.R. 1)
 - Section 965(d), flush language, “To the extent provided in regulations or other guidance prescribed by the Secretary, in the case of any controlled foreign corporation which has shareholders which are not US shareholders, accumulated post-1986 deferred foreign income shall be appropriately reduced by amounts which would be described in subparagraph (B) if such shareholders were US shareholders.” (pg. 147 H.R. 1)
 - Section 965(o) Regulations—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including [to provide appropriate basis adjustments and “prevent the avoidance of the purposes of this section, including through a reduction in E&P, through changes in entity classification or accounting methods, or otherwise.”] (pg. 154 H.R. 1)
30. New Section 951A, GILTI Included in Gross Income of US Shareholders.
- Section 951A(d)(4) [Actually (5) as there appears to be a type creating two number “3”s], Regulations—The Secretary shall issue such regulations or other guidance as the Secretary determines appropriate to prevent the avoidance of the purposes of this subsection, including regulations or other guidance which provide for the treatment of property if (A) such property is transferred, or held, temporarily, or (B) the avoidance of the purposes of this paragraph is a factor in the transfer or holding of such property.” (pg. 157-158 H.R. 1)
 - Section 951A(f) Treatment as Subpart F Income for Certain Purposes includes an “Exception—The Secretary shall provide rules for the application of subparagraph (A) to other provisions of this title in any case in which the determination of subpart F income is required to be made at the level of the CFC.” (pg. 158 H.R. 1)
31. New Section 250, Foreign-Derived Intangible and Global Intangible Low-Taxed Income. Section 250(c), Regulations—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.” (pg. 163 H.R. 1)
32. New Section 267A, Certain Related Party Amounts Paid or Accrued in Hybrid Transactions or with Hybrid Entities. Section 267(e), Regulations—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance providing for—[a list of 7 specific areas of guidance]. (pg. 167 H.R. 1)
33. Amends Section 960, Deemed Paid Credit for Subpart F Inclusions. Added new subsection 960(f) Regulations—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.” (pg. 169 H.R. 1)
34. New Section 59A, Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts (BEAT). Section 59A(ii), Regulations—“The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including regulations—[primarily regarding avoidance of the purposes and terms of section 59A].” (pg. 179 H.R. 1)



KPMG contacts



Tax technical area	Name	Email	Phone
Passthroughs	Deborah Fields	dafields@kpmg.com	+1 202-533-4580
Global mobility services	Martha Klasing Joan Smyth	mklasing@kpmg.com jsmyth@kpmg.com	+1 202-533-4206 +1 202-533-4404
Corporate	Mark Hoffenberg Rob Liquerman	mhoffenberg@kpmg.com rliquerman@kpmg.com	+1 202-533-4058 +1 202-533-3054
Compensation and benefits	Robert Delgado Terri Stecher	rdelgado@kpmg.com tstecher@kpmg.com	+1 858-750-7133 +1 202-533-4830
Estates, gifts, and trusts	Tracy Stone Scott Hamm	ttstone@kpmg.com scotthamm@kpmg.com	+1 202-533-4186 +1 202-533-3095
Insurance	Frederick Campbell-Mohn Sheryl Flum	fcampbellmohn@kpmg.com sflum@kpmg.com	+1 212-954-8316 +1 202-533-3394
Regulated investment companies	Deanna Flores	djflores@kpmg.com	+1 858-342-7661
Banking	Elizabeth L'Hommedieu Matthew Mosby	elhommedieu@kpmg.com mmosby@kpmg.com	+1 614-249-1849 +1 704-371-5265
Other financial products & debt	Kevin Keyes Jon Zelnik	kkeyes@kpmg.com jzelnik@kpmg.com	+1 202-533-3577 +1 202-533-4193
Exempt organizations	Greg Goller Alexandra Mitchell	greggoller@kpmg.com aomitchell@kpmg.com	+1 703-286-8391 +1 202-533-6078
International	Manal Corwin Seth Green Danielle Rolfes Devon Bodoh Ron Dabrowski	mcorwin@kpmg.com sethgreen@kpmg.com drolfes@kpmg.com dbodoh@kpmg.com rdabrowski@kpmg.com	+1 202-533-3127 +1 202-533-3022 +1 202-533-3378 +1 202-533-5681 +1 202-533-4274
Mergers & acquisitions	Thomas Wessel	twessel@kpmg.com	+1 202-533-5700
International M&A	Devon Bodoh	dbodoh@kpmg.com	+1 202-533-5681
Income tax accounting	Eric Lucas	ejlucas@kpmg.com	+1 202-533-3023
Economic & valuation services	Stephen Blough	sblough@kpmg.com	+1 202-533-3108
Energy	Rich Blumenreich Robert Swiech	rblumenreich@kpmg.com rswiech@kpmg.com	+1 202-533-3032 +1 713-319-3257
Financial institutions and products	Mark Price	mhprice@kpmg.com	+1 202-533-4364
Accounting for income taxes	Ashby Corum Jenna Summer	acorum@kpmg.com jsummer@kpmg.com	+1 313-230-3361 +1 202-533-3614
State and local tax	Harley Duncan Ann Holley	hduncan@kpmg.com aholley@kpmg.com	+1 202-533-3254 +1 202-533-3248
Excise and credits	Deborah Gordon Taylor Cortright	dkgordon@kpmg.com tcortright@kpmg.com	+1 202-533-5965 +1 202-533-6188
REITs	David Lee Stephen Giordano	dwlee@kpmg.com stephengiordano@kpmg.com	+1 202-533-4071 +1 202-533-3535

Contact us

For questions on legislative matters, contact a professional in the Federal Legislative & Regulatory Services group of the Washington National Tax office:

John Gimigliano

T: +1 202-533-4022

E: jgimigliano@kpmg.com

Carol Kulish

T: +1 202-533-5829

E: ckulish@kpmg.com

Tom Stout

T: +1 202-533-4148

E: tstoutjr@kpmg.com

Jennifer Bonar Gray

T: +1 202-533-3489

E: jennifergray@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates.

kpmg.com/socialmedia



The information contained herein is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 154 countries and territories and have 200,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

© 2018 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. The KPMG name and logo are registered trademarks or trademarks of KPMG International. NDPPS 733108