TAX CUTS & JOBS ACT

Section by Section

United States Senate
COMMITTEE ON FINANCE

I – TAX REFORM FOR INDIVIDUALS

A. Simplification and Reform of Rates, Standard Deductions, and Exemptions

1. Reduction and simplification of individual income tax rates and modification of inflation adjustment

Current Law: Currently, the Internal Revenue Code (IRC) includes seven brackets for the individual income tax system: 10%, 15%, 25%, 28%, 33%, 35%, and 39.6%. The higher rates apply as a taxpayer's income increases beyond specified thresholds and separate rate schedules apply based on an individual's filing status (single, head-of-household, married-filing-jointly, married-filing-separately, etc.).

Special rules (generally referred to as the "kiddie tax") apply to the net unearned income of certain children. Generally, the kiddie tax applies to a child if: (1) the child has not reached the age of 19 by the close of the taxable year, or the child is a full-time student under the age of 24, and either of the child's parents is alive at such time; (2) the child's unearned income exceeds $2,100 (for 2018); and (3) the child does not file a joint return. Under these rules, the net unearned income of a child is taxed at the parents' tax rates if the parents' tax rates are higher than the tax rates of the child. The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $2,100 (for 2018), less the child's standard deduction) is taxed at the child's rates.

Under current law, paid preparers are subject to a due diligence requirement in determining the eligibility for, or the amount of, the amount of the credit allowable by sections 24 (child tax credit), 25A(a)(1) (American opportunity tax credit), or 32 (earned income tax credit). Failure to comply with the due diligence requirement results in a penalty of $500 for each such failure.

In the Mark: This provision modifies the bracket schedule, setting the brackets at: 10%, 12%, 22.5%, 25%, 32.5%, 35%, and 38.5%. The income brackets to which these tax rates apply, according to filing status, are summarized below.

Single Taxpayers

Taxable Income:	Marginal Rate:
$0-$9,525	10%
$9,526-$38,700	12%
$38,701- $60,000	22.5%
$60,001-$195,400	25%
$195,401- $250,000	32.5%
$250,001-$500,000	35%
$500,001 +	38.5%

Married, Joint Filing

Taxable Income:	Marginal Rate:
0-$19,050	10%
$19,051-$77,400	12%
$77,401-$120,000	22.5%
$120,001-$237,900	25%
$237,901- $300,000	32.5%
$300,001-$1,000,000	35%
$1,000,001+	38.5%

Head of Household

Taxable Income:	Marginal Rate:
0-$13,600	10%
$13,601-$51,800	12%
$51,801- $60,000	22.5%
$60,001-$195,400	25%
$195,401- $250,000	32.5%
$250,001-$500,000	35%
$500,001 +	38.5%

Estates and Trusts

Taxable Income:	Marginal Rate:
$0-$2550	10%
n/a	12%
n/a	22.5%
$2,551-$9,150	25%
n/a	32.5%
$9,151-$12,500	35%
$12,501 +	38.5%

No changes to the tax treatment of capital gains or dividends are included in the mark.

This provision also simplifies the "kiddie tax" by applying ordinary and capital gains applicable to estates and trusts to the net unearned income of a child.

The provision also expands the due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household. A penalty of $500 is imposed for each such failure.

JCT Estimate: This provision would reduce revenues by $1.326 trillion over 10 years.

2. Increase in standard deduction

Current Law: Under current law, taxpayers reduce their adjusted gross income (AGI) by the standard deduction or the sum of itemized deductions to determine taxable income. For 2018, the standard deduction amounts, indexed to inflation, are: $6,500 for single individuals and married individuals filing separately; $9,550 for heads of household, and $13,000 for married individuals filing jointly (including surviving spouses). Additional standard deductions may be claimed by taxpayers who are elderly or blind.

In the Mark: This provision increases the basic standard deduction. Beginning in 2018, the basic standard deduction amounts would be increased to: $12,000 for single individuals and married individuals filing separately; $18,000 for heads of household, and; $24,000 for married individuals filing jointly (including surviving spouses).

JCT Score: Expanding the standard deduction in the manner described would reduce revenues by $919.8 billion over 10 years.

3. Repeal of deduction for personal exemptions

Current Law: Under current law, taxpayers determine their taxable income by subtracting from their adjusted gross income any personal exemption deductions. Personal exemptions generally are allowed for the taxpayer, the taxpayer's spouse, and any dependents. For 2018, the amount deductible for each personal exemption is $4,150. The personal exemption phases out for taxpayers above certain AGI thresholds.

In the Mark: This provision repeals the deduction for personal exemptions.

JCT Estimate: This provision would increase revenues by roughly $1.5 trillion over 10 years.

4. Alternative inflation measure

Current Law: Under current law, many parameters of the tax system are adjusted for inflation to protect taxpayers from the effects of rising prices. Most of the adjustments are based on annual changes in the level of the Consumer Price Index for all Urban Consumers ("CPI-U"). Inflation-indexed parameters in the individual tax system include: (1) the regular income tax brackets; (2) the basic standard deduction; (3) the additional standard deduction for aged and blind; (4) the personal exemption amount; (5) the thresholds for the overall limitation on itemized deductions and the personal exemption phase-out; (6) the phase-in and phase-out thresholds of the earned income credit; (7) IRA contribution limits and deductible amounts; and (8) the saver's credit.

In the Mark: This provision requires the use of a more accurate measure of inflation than the CPI-U for the adjustment of parameters in the individual tax system.

JCT Estimate: This provision would increase revenues by $131.2 billion over 10 years.

B. Treatment of Business Income of Individuals

1. Allow 17.4-percent deduction to certain pass-through income

Current law: In general, businesses organized or conducted as sole proprietorships, partnerships, limited liability companies, and S corporations are not subject to an entity level income tax. Instead, the net income of these pass-through businesses is reported by the owners or shareholders on their individual income tax returns and is subject to ordinary income tax rates.

In the Mark: This provision allows for a deduction in an amount equal to 17.4 percent of domestic qualified business income ("QBI") of pass-through entities. QBI is defined as all domestic business income other than investment income (e.g. dividends (other than qualified real estate investment trust dividends and cooperative dividends), investment interest income, short-term capital gains, long-term capital gains, commodities gains, foreign currency gains, etc.). For pass-through entities, other than sole proprietorships, the deduction cannot exceed 50% of wages paid (including wages of both employees and owners/shareholders).

QBI does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer (as determined under current law). QBI also does not include any amount paid by a partnership that is a guaranteed payment under section 707(c) or a section 707(a) payment for services.

The deduction is not available for specified services, as defined in section 1202(e)(3)(A); however, an exception is provided for taxpayers under a certain taxable income threshold ($75,000 for singles; $150,000 for married filing jointly; both indexed for inflation). The benefit of the deduction for service providers is fully phased out at taxable income levels of $100,000 for singles and $200,000 for married filing jointly (both indexed for inflation).

JCT Estimate: This provision would reduce revenues by $459.7 billion over 10 years.

2. Limitation on losses for taxpayers other than corporations

Current Law: Under current law, passive loss rules limit deductions and credits from passive trade or business activities. The passive loss rules apply to individuals, estates and trusts, and closely held corporations. In general, a passive activity is a trade or business activity in which the taxpayer owns an interest, but in which the taxpayer does not materially participate. Under the rules, deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the subsequent year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person.

In the Mark: This provision would provide that excess business losses of a taxpayer other than a C corporation (e.g., losses from sole proprietorships) are not allowed for the taxable year. They are carried forward and treated as part of the taxpayer's net operating loss carryforward in subsequent taxable years.

An excess business loss is a taxpayer's net, aggregate current-year pass-through loss above $250,000 for singles and $500,000 for married filing jointly (both indexed for inflation). As a result of this provision, up to $250,000/$500,000 of net, aggregate current-year pass-through losses can offset current-year non-pass-through income (i.e., investment income and wage income, including such income earned by a spouse on a married-filing-jointly return).

The provision generally would affect individuals who are active in trade or business activities they own and whose trade or business throws off relatively large losses. As noted above, passive losses of individuals are limited under the present-law passive loss rules.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner's or S corporation shareholder's share of items of income, gain, deduction, or loss of the partnership or S corporation are taken into account in applying the limitation under this provision for the taxable year of the partner or S corporation shareholder.

JCT Estimate: This provision would increase revenues by $175.6 billion over 10 years.

C. Reform of Child Tax Benefits

1. Reform of the child tax credit

Current Law: Under current law, a taxpayer may claim a child tax credit (CTC) of up to $1,000 per qualifying child under the age of 17. The aggregate amount of CTCs that can be claimed phases out by $50 for each $1,000 of AGI over $75,000 for single filers, $110,000 for married filers, and $55,000 for married individuals filing separately.

To the extent that the CTC exceeds a taxpayer's liability, a taxpayer is eligible for a refundable credit, known as the additional child tax credit.

Current law requires a taxpayer claiming the CTC to include a valid Taxpayer Identification Number (TIN) for each qualifying child on their return. In most cases, the TIN will be the child's Social Security Number (SSN), although Individual Taxpayer Identification Numbers (ITINs) are also accepted.

In the Mark: This provision increases the value of the CTC to $1,650 per qualifying child, with up to $1,000 being refundable. The provision also includes a nonrefundable $500 tax credit for a taxpayer's non-child dependents. In addition, it increases the phase-out threshold for the CTC to $500,000 for both single, head of household, and married joint filers. The provision also increases the age of a qualifying child to 18 years. In addition, it requires taxpayers to provide a SSN for each qualifying child in order to claim the refundable portion of the CTC.

JCT Estimate: The expansion of the CTC would decrease revenues by $581.8 billion over ten years. The requirement for a valid SSN for each child would increase revenues by $24.1 billion over 10 years.

2. Modification of section 529 education

Current Law: Section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs. In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a "savings account program"). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary's higher education expenses. In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary.

In the Mark: The provision provides that an unborn child may be treated as a designated beneficiary or an individual under section 529 plans. An unborn child means a child in utero. A child in utero means a member of the species homo sapiens, at any stage of development, who is carried in the womb.

D. Simplification and Reform of Deductions

1. Repeal of deduction for taxes not paid or accrued in a trade or business

Current Law: Current law allows taxpayers to deduct from their taxable income several types of taxes paid at the state and local level, including real and personal property taxes, income taxes, and/or sales taxes.

In the Mark: This provision repeals the deduction for the payment of any state and local taxes not incurred in carrying on a trade or business or an activity for the production of income. This provision would be effective for tax years beginning after December 31, 2017.

JCT Estimate: See note below.

2. Modification of deduction for home mortgage interest

Current Law: Under current law, a taxpayer may claim an itemized deduction for "qualified residence interest," which includes interest paid on a mortgage secured by a principal residence or a second residence. The underlying mortgage loans can represent acquisition indebtedness of up to $1 million, plus home equity indebtedness of up to $100,000.

In the Mark: This provision eliminates the deduction for home equity loan interest.

JCT Estimate: See note below.

3. Modification of deduction for personal casualty and theft losses

Current Law: Current law generally allows taxpayers to claim an itemized deduction for uncompensated personal casualty losses, including those arising from fire, storm, shipwreck, or other casualty, or from theft.

In the Mark: This provision strikes "fire, storm, shipwreck, or other casualty, or from theft" and inserts "a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act" for all losses incurred in taxable years beginning after December 31, 2017.

JCT Estimate: See note below.

4. Increase percentage limit for charitable contributions of cash to public charities

Current Law: In general, contributions to charitable organizations may be deducted up to 50 percent of adjusted gross income. Contributions to certain private foundations, veterans organizations, fraternal societies, and cemetery organizations are limited to 30 percent of adjusted gross income. The 50 percent limitation applies to public charities and certain private foundations.

In the Mark: The 50-percent limitation for cash contributions to public charities and certain private foundations is increased to 60 percent. The provision would retain the 5-year carryover period to the extent that the contribution amount exceeds 60 percent of the donor's AGI.

JCT Estimate: See note below.

5. Repeal of the overall limitation on itemized deductions

Current Law: Under current law, certain higher-income taxpayers who itemize their deductions are subject to a limitation on such deductions, commonly known as the "Pease limitation." For taxpayers who exceed the threshold, the otherwise allowable amount of itemized deductions is reduced by 3% of the amount of the taxpayers' adjusted gross income exceeding the threshold. The total reduction, however, cannot be greater than 80% of all itemized deductions, and certain itemized deductions are exempt from the Pease limitation.

In the Mark: This provision repeals the "Pease limitation" on itemized deductions for taxable years beginning after 2017.

JCT Estimate: See note below.

6. Modification of exclusion of gain from sale of principal residence

Current Law: Currently, a taxpayer may exclude from gross income up to $250,000 of gain ($500,000 in the case of married taxpayers filing jointly) from the sale or exchange of a principal residence. The taxpayer (or spouse) must have owned and occupied the residence for at least two of the previous five years.

In the Mark: This provision changes the ownership qualification time for the exclusion, requiring the taxpayer (or spouse) to have owned and occupied the residence for at least five of the previous eight years. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances, is able to exclude an amount equal to a percent of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the five years that the ownership and use requirements are met.

JCT Estimate: This provision would increase revenues by $1.1 billion over 10 years.

7. Repeal of exclusion for qualified bicycle commuting reimbursement

Current Law: Current law allows an employee to exclude up to $20 per month in qualified bicycle commuting reimbursements. Qualified reimbursements are any amount received from an employer during a 15-month period beginning with the first day of the calendar year as payment for reasonable expenses during a calendar year.

In the Mark: The provision repeals the exclusion from gross income and wages for qualified bicycle commuting reimbursements.

JCT Estimate: This provision would increase revenues by less than $50 million over 10 years.

8. Repeal of exclusion for qualified moving expense reimbursement

Current Law: Qualified moving expense reimbursements are excluded from an employee's gross income, and are defined as any amount received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses which would be deductible as moving expenses under section 217 if directly paid or incurred by the employee. However, qualified moving expense reimbursements do not include amounts actually deducted by the individual. Amounts excludible from gross income for income tax purposes as qualified moving expense reimbursements are also excluded from wages for employment tax purposes.

In the Mark: This provision repeals the exclusion for qualified moving expense reimbursements for tax years beginning after 2017.

JCT Score: This provision would increase revenues by $6.1 billion over 10 years.

9. Repeal of deduction for moving expenses

Current Law: Taxpayers may currently claim a deduction for moving expenses incurred in connection with starting a new job. The new workplace must be at least 50 miles farther from a taxpayer's former residence than the former place of work.

In the Mark: This provision repeals the deduction for moving expenses for tax years beginning after 2017, retaining it only for members of the Armed Forces.

JCT Score: This provision would increase revenues by $9.7 billion over 10 years.

10. Modification to the limitation on wagering losses

Current Law: Under current law, taxpayers can claim a deduction for wagering losses to the extent of wagering winnings. Other deductions connected to wagering may also be claimed regardless of wagering winnings.

In the Mark: Effective for tax years beginning after 2017, this provision modifies current law to require that all deductions for expenses incurred in relation to wagering be limited to the extent of wagering winnings.

JCT Estimate: This provision would increase revenues by $100 million over 10 years.

11. Repeal of deduction for tax preparation expenses

Current Law: Taxpayers are allowed under current law to deduct expenses paid or incurred in connection with the determination, collection or refund of any tax.

In the Mark: This provision repeals this deduction for tax years beginning after 2017.

JCT Estimate: See note below.

12. Repeal of miscellaneous itemized deductions subject to the two-percent floor

Current Law: Individuals may claim itemized deductions for various expenses. Some of these itemized deductions, referred to as miscellaneous itemized deductions, are not deductible unless they exceed, in the aggregate, two percent of the taxpayer's adjusted gross income.

In the Mark: The provision repeals all miscellaneous itemized deductions that are subject to the two-percent floor.

JCT Estimate: See note below.

Note: According to estimates by the Joint Committee on Taxation, repealing the itemized deductions for taxes not paid or accrued in a trade or business, interest on home equity debt, non-disaster casualty losses, tax preparation expenses, and certain miscellaneous expenses, as well as the provision to increase the percentage limit for charitable contributions of cash to public charities would increase revenues by $1.266 trillion over 10 years.

E. Increase in Estate and Gift Tax Exemption

Current Law: Current law generally subjects property in an estate to a top estate tax rate of 40 percent prior to transfer to the estate's beneficiaries. Property transferred during the life of the donor is subject to a top gift tax rate of 40 percent, with an exclusion for the first $14,000 per year, per donee. Property transferred beyond a single generation is subject to a top generation-skipping tax rate of 40 percent. All three taxes include an exemption that is adjusted annually for inflation. For 2017, the exemption amount is $5.49 million. Any unused exemption amount passes to a donor's surviving spouse and the combined exemption amount for a married couple is $10.98 million for 2017.

In the Mark: This provision roughly doubles the basic exemption amount for estate, gift, and generation-skipping transfer taxes, beginning for tax years after 2017 (approximately $11 million for individuals, $22 million for couples).

JCT Estimate: This provision would reduce revenues by $93.8 billion over 10 years.

II – ALTERNATIVE MINIMUM TAX REPEAL

1. <u>Repeal of alternative minimum tax on individuals</u>

Current Law: Current law requires individuals to compute their income for purposes of both the regular income tax and the alternative minimum tax (AMT), and their tax liability is equal to the greater of the two. The AMT has a 26% bracket and a 28% bracket with an exemption amount that phases out at various income ranges.

In the Mark: This provision repeals the individual AMT for tax years beginning after 2017.

The provision also allows any AMT credit carryforwards to offset the taxpayer's regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2018 and before 2023 in an amount equal to 50% (100% in the case of taxable years beginning in 2022) of the excess of the minimum tax credit for the taxable year over the amount of the credit allowable for the year against regular tax liability.

JCT Estimate: Repeal of the individual AMT would reduce revenues by $706.7 billion over 10 years.

2. Repeal of alternative minimum tax on corporations

Current Law: Under current law, the corporate Alternative Minimum Tax (AMT) is 20 percent, with an exemption amount of up to $40,000. Corporations with average gross receipts of less than $7.5 million for the preceding three tax years are exempt from the AMT. The exemption amount phases out starting at $150,000 of alternative minimum taxable income.

In the Mark: This provision repeals the corporate AMT. If there is currently a carryforward AMT credit available, the taxpayer would be able to claim a refund of 50 percent of the remaining credits in tax years beginning in 2019, 2020, and 2021. Taxpayers would be able to claim a refund of all remaining credits in the tax year beginning in 2022.

JCT Estimate: This provision would reduce revenues by $40.3 billion over 10 years.

III – BUSINESS TAX REFORM

A. Tax Rates

1. Reduction in corporate tax rate

Current Law: There is a graduated rate structure imposed on the taxable income of corporations of 15%, 25%, 34%, and 35%. Two additional surtaxes can apply the first of which eliminates the benefits of the 15% and 25% rates for taxable income between $100,000 and $335,000. The second surtax eliminates the benefit of the 34% rate for taxable income between $15 million and $18,333,333. Certain personal service corporations pay the 35% tax rate on all taxable income.

In the Mark: This provision eliminates the graduated corporate rate structure and replaces it with a single corporate tax rate of 20 percent, effective January 1, 2019.

JCT Estimate: This provision would decrease revenues by $1.3292 trillion over 10 years.

2. Reduction of dividends received deduction percentages

Current Law: Under current law, corporations that receive dividends from other corporations are entitled to a deduction for dividends received. Affiliated firms (firms with a common parent owning 80% of the stock) are allowed a 100% dividends received deduction. If the corporation owns at least 20% of the stock of another corporation, an 80% dividends received deduction is allowed. Otherwise a 70% deduction is allowed. There is also a limit on the deduction of dividends when portfolio stock is debt financed that disallows the share that is debt financed. Portfolio stock is stock in a firm that is less than 50% owned.

In the Mark: This provision would reduce the 80% dividends received deduction to 65% and the 70% dividends received deduction to 50%.

JCT Estimate: This provision would increase revenues by $5.1 billion over 10 years.

B. Small Business Reforms

1. Modification of rules for expensing depreciable business assets

Current Law: Current law generally requires taxpayers to capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization. Section 179 allows taxpayers to expense up to $500,000 in qualified property costs placed in service during the taxable year. That amount is reduced by the amount by which the costs of the qualified properties exceeds $2,000,000. Both the $500,000 and $2,000,000 amounts are indexed for inflation.

In the Mark: This provision increases the maximum expensing under Section 179 to $1,000,000 and increases the phase-out threshold amount to $2,500,000 (both amounts are indexed for inflation).

JCT Estimate: This provision would decrease revenues by $24 billion over 10 years.

2. Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships

Current Law: The cash method of accounting generally allows a business to recognize income and deduct expenses when the cash is received or paid, rather than having to accrue income and expenses. Under current law, C corporations and partnerships with a C corporation partner may only use the cash method if they have average annual gross receipts of $5 million or less during the preceding three years. Businesses structured or conducted as sole proprietorships, partnerships (with non-C corporation partners), LLCs, and S corporations generally may use the cash method regardless of the amount of their gross receipts. Farm corporations and farm partnerships with a corporate partner may only use the cash method if their gross receipts do not exceed $1 million in any year. An exception allows certain family farm corporations to use the cash method if their gross receipts do not exceed $25 million.

In the Mark: The provision would increase to $15 million the threshold for small corporations and partnerships with a corporate partner to qualify for the cash method of accounting. The provision also would increase the general farm corporation limit to $15 million, but not reduce the limit for family farm corporations.

JCT Estimate: See note below.

3. Clarification of inventory accounting rules for small businesses

Current Law: Under current law, businesses that are required to use an inventory method also must use the accrual method of accounting for tax purposes (except for certain small businesses with average gross receipts of not more than $1 million).

In the Mark: The provision exempts certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that meet the $15 million gross receipts test as described above are not required to account for inventories under section 471, but rather may use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.

JCT Estimate: See note below.

4. Modification of rules for uniform capitalization of certain expenses

Current Law: The uniform capitalization (UNICAP) rules generally require a business to capitalize the direct and indirect costs associated with inventory and recover such costs when the inventory is sold, rather than when the costs are incurred. Under current law, a business with average annual gross receipts of $10 million or less in the preceding three years is not subject to the UNICAP rules for personal property acquired for resale. The exemption does not apply to real property (e.g., buildings) or personal property that is manufactured by the business.

In the Mark: The provision would provide a comprehensive exemption from the UNICAP rules for businesses meeting the $15 million threshold proposed for the cash method of accounting described above. The provision also would expand the exemption to apply to real or personal property acquired for resale or manufactured by the business, provided it meets the $15 million threshold.

JCT Estimate: See note below.

5. Increase in gross receipts test for construction contract exception to percentage of completion method

Current Law: Under current law, construction companies with average annual gross receipts of $10 million or less in the preceding three years are permitted to deduct costs associated with construction when they are paid and recognize income when the building is completed. Other businesses generally are required to account for longer-term contracts under the percentage-of-completion method, which allows for deductions and income recognition each year based on the percentage of the contract completed.

In the Mark: The provision would increase the threshold to $15 million for the completed-contract method, which is used primarily to account for small construction contracts.

JCT Estimate: See note below.

Note: According to estimates by the Joint Committee on Taxation, the reforms to accounting rules for small businesses listed as **Numbers 2-5 above** would reduce revenues by a total of $27.6 billion over 10 years.

C. Cost Recovery, etc.

1. Limitation on deduction for interest

Current Law: Under current law, section 163(j) limits the ability of a corporation to deduct disqualified interest paid or accrued in a taxable year if two threshold tests are met: (1) the corporation's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio); and (2) the corporation's net interest expense exceeds 50% of its adjusted taxable income. Generally, adjusted taxable income is the corporation's taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion. Interest amounts disallowed under these rules can be carried forward indefinitely. In addition, any excess limitation (i.e., the excess, if any, of 50% of the adjusted taxable income of the corporation over the corporation's net interest expense) can be carried forward three years.

In the Mark: Under the provision, every business, regardless of its form, would be subject to a disallowance of deduction for net interest expense in excess of 30% of the business's adjusted taxable income. The net interest expense disallowance would be determined at the tax filer level—for example, at the partnership level instead of the partner level.

Adjusted taxable income is a business's taxable income computed without regard to business interest expense, business interest income, the 17.4 percent deduction for certain pass-through income, net operating losses, and other adjustments as provided by the Secretary of Treasury. Any interest amounts disallowed under the provision would be carried forward to future taxable years.

The provision would provide an exemption from these rules for businesses with average annual gross receipts under $15 million during the three preceding years, indexed for inflation.

Additionally, the provision would not apply to certain regulated public utilities and electing real property trades or businesses.

JCT Estimate: This provision would increase revenues by $308.3 billion over 10 years.

2. Temporary 100-percent expensing for certain business assets

Current Law: Current law generally requires taxpayers to capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization. Currently, taxpayers may take additional depreciation in the year in which certain qualified property is placed in service through 2019 (with an additional year for property with a longer production period).

In the Mark: This provision allows taxpayers to immediately expense 100 percent of the cost of qualified property acquired and placed into service after September 27, 2017, and before the end of 2022 (with an additional year for property with a longer production period). The provision also excludes from the definition of qualified property certain public utility property.

JCT Estimate: This provision would reduce revenues by $61.3 billion over 10 years.

3. Modifications to depreciation limitations on luxury automobiles and personal use property

Current Law: Section 280F(a) limits the annual cost recovery deduction with respect to certain passenger automobiles. This limitation is commonly referred to as the "luxury automobile depreciation limitation." For passenger automobiles placed in service in 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation deduction is $3,160 for the year in which the vehicle is placed in service, $5,100 for the second year, $3,050 for the third year, and $1,875 for the fourth and later years in the recovery period. This limitation is indexed for inflation and applies to the aggregate deduction provided under present law for depreciation and section 179 expensing. Hence, passenger automobiles subject to section 280F are eligible for section 179 expensing only to the extent of the applicable limits contained in section 280F. For passenger automobiles eligible for the additional first-year depreciation allowance in 2017, the first-year limitation is increased by an additional $8,000.

In the case of certain listed property, special rules apply. Listed property generally is defined as (1) any passenger automobile; (2) any other property used as a means of transportation; (3) any property of a type generally used for purposes of entertainment, recreation, or amusement; (4) any computer or peripheral equipment; and (5) any other property of a type specified in Treasury regulations.

In the Mark: The provision increases the depreciation limitations under section 280F that apply to listed property. For passenger automobiles placed in service after December 31, 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period. The limitations are indexed for inflation for passenger automobiles placed in service after 2018.

The provision removes computer or peripheral equipment from the definition of listed property. Such property is therefore not subject to the heightened substantiation requirements that apply to listed property.

JCT Estimate: Reflected in estimate of bonus depreciation above**.**

4. Modifications of treatment of certain farm property

Current Law: Property used in a farming business is assigned various cost recovery periods in the same manner as other business property. For example, depreciable assets used in agriculture activities that are assigned a recovery period of 7 years include machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agriculture, animal husbandry, and horticultural services. Cotton ginning assets are also assigned a recovery period of 7 years, while land improvements such as drainage facilities, paved lots, and water wells are assigned a recovery period of 15 years. A 5-year recovery period was assigned to new farm machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which was used in a farming business, the original use of which commenced with the taxpayer after December 31, 2008, and which was placed in service before January 1, 2010.

Any property (other than nonresidential real property, residential rental property, and trees or vines bearing fruits or nuts) used in a farming business is subject to the 150-percent declining balance method.

Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures are required to depreciate all farming assets using the alternative depreciation system (*i.e.*, using longer recovery periods and the straight line method).

In the Mark: The provision would restore the provision, which expired at the end of 2009, that permitted farmers and ranchers to depreciate most farm machinery and equipment over five years rather than seven years. The provision also would repeal the rule under current law that requires property used in a farm business to be depreciated more slowly than in other industries.

JCT Estimate: This provision reduces revenue by $1.1 billion over 10 years.

5. Modification of net operating loss deduction

Current Law: Under current law, taxpayers can carry a net operating loss (NOL) deduction back two years and forward 20 years in offsetting taxable income. Additionally, a special five-year carryback applies to farming NOLs.

In the Mark: This provision eliminates the carryback option, but allows for indefinite carryforward of NOLs. The provision includes an exception for farming NOLs, which are permitted a 2-year carryback. The provision limits the NOL deduction to 90 percent of taxable income (determined without regard to the deduction).

JCT Estimate: This provision would increase revenues by $170.4 billion over 10 years.

6. Like-kind exchanges of real property

Current Law: Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, through the sale of property giving rise to the gain or loss). An exception to the recognition of gain or loss is provided if property held for use in a trade or business or for investment is exchanged for property of a like kind that is to be held in a trade or business or for investment. Personal property or real property may be the subject of like kind exchanges.

In the Mark: This provision modifies the current law non-recognition of gains from like-kind exchanges by limiting its application to real property that is not held primarily for sale.

JCT Estimate: This provision would increase revenues by $30.5 billion over 10 years

7. Applicable recovery period for real property

Current Law: The cost recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method and mid-month convention are required for the aforementioned real property.

The recovery period for any addition or improvement to real or personal property begins on the later of (1) the date on which the addition or improvement is placed in service, or (2) the date on which the property with respect to which such addition or improvement is made is placed in service. Any MACRS deduction for an addition or improvement to any property is to be computed in the same manner as the deduction for the underlying property would be if such property were placed in service at the same time as such addition or improvement. Thus, for example, the cost of an improvement to a building that constitutes nonresidential real property is recovered over 39 years using the straight line method and mid-month convention. Certain improvements to nonresidential real property are eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met (*i.e.*, improvements that constitute "qualified improvement property").

In the Mark: The provision shortens the recovery period for determining the depreciation deduction with respect to nonresidential real and residential rental property to 25 years. The provision eliminates the separate definitions of qualified leasehold improvement, qualified restaurant property, and qualified retail improvement property, and provides a general 10-year recovery period for qualified improvement property, and a 20-year alternative depreciation system (ADS) recovery period for such property.

The provision also requires a real property trade or business electing out of the limitation on the deduction for interest expense to use ADS to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property.

JCT Estimate: This provision would reduce revenues by $5.7 billion over 10 years.

D. Reform of Business-Related Exclusions and Deductions

1. Repeal of deduction for income attributable to domestic production activities

Current Law: Under current law, section 199 allows a deduction equal to 9% of the lesser of taxable income derived from qualified production activities, or taxable income (determined without regard to the section 199 deduction). Qualified production activities are defined to include manufacturing, mining, electricity and water production, film production, and domestic construction, among other activities. For oil- and gas-related activities, the deduction is limited to 6%. Qualifying oil and gas activities include the production, refining, processing, transportation, or distribution of oil, gas, or any primary product thereof. Across all sectors, the deduction cannot exceed 50% of W-2 wages paid by the taxpayer for qualifying activities.

In the Mark: This provision repeals the section 199 deduction for income attributable to domestic production activities.

JCT Estimate: This provision would increase revenues by $80.7 billion over 10 years.

2. Limitation on deduction by employers of expenses for fringe benefits

Current Law: Under current law, a taxpayer may deduct up to 50 percent of expenses relating to meals and entertainment.

Housing and meals provided for the convenience of the employer on the business premises of the employer are excluded from the employee's gross income. Various other fringe benefits provided by employers are not included in an employee's gross income, such as qualified transportation fringe benefits.

In the Mark: This provision would bar deductions for entertainment expenses, and eliminate the subjective determination of whether such expenses are sufficiently business related; expand the current 50% limit on the deductibility of business meals to meals provided through an in-house cafeteria or otherwise on the premises of the employer; deny deductions for employee transportation fringe benefits (e.g., parking and mass transit) but retain the exclusion from income for such benefits received by an employee.

Additionally it will preclude deductions for transportation expenses that are the equivalent of commuting for employees (e.g., between the employee's home and the workplace), except as provided for the safety of the employee.

JCT Estimate: This provision would increase revenues by $39.8 billion over 10 years.

E. Accounting Methods

1. Certain special rules for taxable year of inclusion

Current Law: In general, a taxpayer is generally required to include an item in income no later than the time of its actual or constructive receipt, unless the item properly is accounted for in a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.

In general, for a cash basis taxpayer, an amount is included in income when actually or constructively received. For an accrual basis taxpayer, an amount is included in income the earlier of when such amount is earned by, due to, or received by the taxpayer, unless an exception permits deferral or exclusion.

A number of exceptions exist to permit deferral of income relate to advanced payments. Advance payment situations arise when amounts are received by the taxpayer in advance of when goods or services are provided by the taxpayer to its customer. The exceptions often allow tax deferral to mirror financial accounting deferral (e.g., income is recognized as the goods are provided or the services are performed).

In the Mark: This provision revises the rules associated with the recognition of income. Specifically, the provision requires a taxpayer to recognize income no later than the taxable year in which such income is taken into account as income on an audited financial statement or another financial statement under rules specified by the Secretary, but provides an exception for long-term contract income to which section 460 applies.

The provision also codifies the current deferral method of accounting for advance payments for goods and services provided by the IRS under Revenue Procedure 2004-34. That is, the provision allows taxpayers to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income is deferred for financial statement purposes.

Finally, the provision directs taxpayers to apply the revenue recognition rules under section 451 before applying the original issue discount rules under section 1272.

JCT Estimate: This provision would increase revenues by $17.6 billion over 10 years.

F. Business Credits

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

Current Law: Since 1983, businesses investing in the development of drugs to diagnose, treat, or prevent qualified rare diseases (affecting fewer than 200,000 persons in the United States) and conditions have been able to claim a non-refundable tax credit equal to 50% of certain qualified clinical testing expenses incurred or paid during the development process. These drugs are known as orphan drugs.

To prevent a company from receiving a double tax benefit for the same expenditure, the tax code restricts the credits and deductions a business claiming the orphan drug tax credit may take in the same year. More specifically, expenses used to claim the orphan drug tax credit cannot also be used to claim the section 41 research and development tax credit.

In the Mark: This provision limits the orphan drug credit to the qualified clinical testing expenses that exceed 50% of the average of such expenses for the three preceding taxable years. If there are no clinical testing expenditures, the rate will be 17.5% of expenses for that year. The credit would also not apply to testing a drug if the drug has previously been used to treat any other disease or condition, and if all diseases combined affect more than 200,000 people.

JCT Estimate: This provision would increase revenues by $29.7 billion over 10 years.

2. Modification of rehabilitation credit

Current Law: Qualified rehabilitation expenditures with respect to certified historic structures qualify for a 20-percent tax credit. A certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.

Section 47 also provides a 10-percent tax credit for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building first placed in service before 1936.

In the Mark: This provision limits the credit to certified historic structures and reduces the credit rate from 20% to 10%. The 10% credit for structures other than certified historic structures is eliminated.

This provision is effective for tax years beginning after December 31, 2017. A transition rule provides that current law and not the provision will remain in effect for projects where the building is owned or leased by the taxpayer at all times on or after January 1, 2018, and where the 24-month period selected by the taxpayer for claiming the credit begins not later than 180 days of enactment.

JCT Estimate: This provision would increase revenues by $4.3 billion over 10 years.

3. Repeal of deduction for certain unused business credits

Current Law: General Business Credits (GBCs) may be carried back one year and forward 20 years. If any GBCs go unutilized, then section 196 allows a deduction for them.

In the Mark: The provision repeals the deduction for certain unused business credits.

JCT Estimate: This provision has negligible revenue effect.

G. Banks and Financial Instruments

1. <u>Limitation on deduction for FDIC premiums</u>

Current Law: The Federal Deposit Insurance Corporation ("FDIC") provides deposit insurance for banks and savings institutions. To maintain its status as an insured depository institution, a bank must pay semiannual assessments into the deposit insurance fund. Assessments for deposit insurance are treated as ordinary and necessary business expenses. These assessments, also known as premiums, are deductible once the all events test for the premium is satisfied.

In the Mark: No deduction is allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer. For taxpayers with total consolidated assets of $50 billion or more, the applicable percentage is 100 percent. Otherwise, the applicable percentage is the ratio of the excess of total consolidated assets over $10 billion to $40 billion. For example, for a taxpayer with total consolidated assets of $20 billion, no deduction is allowed for 25 percent of FDIC premiums. The provision does not apply to taxpayers with total consolidated assets (as of the close of the taxable year) that do not exceed $10 billion.

JCT Estimate: This provision would increase revenues by $14.5 billion over 10 years.

2. <u>Repeal of advance refunding of bonds</u>

Current Law: Under current law, the exclusion from gross income for interest on State and local bonds applies to refunding bonds but with limits on advance refunding bonds. A refunding bond is any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds. An advance refunding occurs when the refunding bonds are issued more than 90 days before the redemption of the refunded bond.

In the Mark: The provision repeals the exclusion from gross income for interest on a bond issued to advance refund another bond.

JCT Estimate: This provision would increase revenues by $16.8 billion over 10 years.

3. <u>Cost basis of specified securities determined without regard to identification</u>

Current Law: If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares deemed sold are the earliest acquired shares (the "first-in-first-out rule"). If a taxpayer makes an adequate identification ("specific identification") of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified. A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to elect, in lieu of the specific identification or first-in-first-out methods, to determine the basis of RIC shares sold under one of two average-cost-basis methods described in Treasury regulations (together, the "average basis method").

A broker is required to report to the IRS a customer's adjusted basis in a covered security that the customer has sold and whether any gain or loss from the sale is long-term or short-term. A covered security is, in general, any specified security acquired after an applicable date specified in the basis reporting rules.

For purposes of satisfying the basis reporting requirements, a broker must determine a customer's adjusted basis in accordance with rules intended to ensure that the broker's reported adjusted basis numbers are the same numbers that customers must use in filing their tax returns.

In the Mark: This provision requires that the cost of any specified security sold, exchanged, or otherwise disposed of on or after January 1, 2018, be determined on a first-in first-out basis except to the extent the average basis method is otherwise allowed (as in the case of stock of a RIC). The provision includes several conforming amendments, including a rule restricting a broker's basis reporting method to the first-in first-out method in the case of the sale of any stock for which the average basis method is not permitted.

JCT Estimate: This provision would increase revenues by $2.7 billion over 10 years.

H. Compensation

1. Nonqualified deferred compensation

Current Law: Under current law, compensation is generally taxable to an employee and deductible by an employer in the year earned. There are exceptions in the case of contributions to pensions, where the employer can take a deduction but the employee is not taxed until receipt of a distribution from the plan. Second, for nonqualified deferred compensation, the employee does not take compensation into income until received but the employer's deduction is also postponed to that time. If the employee is located in a jurisdiction where the employer is not effectively subject to income taxes (in certain foreign jurisdictions) the compensation is immediately taxable as soon as it is not subject to a substantial risk or forfeiture. Other rules apply to tax-exempt organizations and state and local governments, where the employee may defer tax that meets limits for 401(k) plans ($18,000 for 2017).

In the Mark: Under the provision, the employee is taxed on compensation as soon as there is no substantial risk of forfeiture (that is, the compensation does not depend on the future performance of substantial services). The attainment of one or more performance goals or the occurrence of a condition related to a purpose of the compensation other than the performance of services, or a covenant not to compete are not considered conditions creating a substantial risk of forfeiture.

JCT Estimate: This provision would increase revenues by $13.4 billion over 10 years.

2. Modification of limitation on excessive employee remuneration

Current Law: Under current law, a corporation generally may deduct compensation expenses as an ordinary and necessary business expense. The deduction for compensation paid or accrued with respect to a covered employee of a publicly traded corporation, however, is limited to no more than $1 million per year. The deduction limitation applies to all remuneration paid to a covered employee for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash, subject to several significant exceptions: (1) commissions; (2) performance-based remuneration, including stock options; (3) payments to a tax-qualified retirement plan; and (4) amounts that are excludable from the executive's gross income.

A covered employee is the chief executive officer (CEO) and the next four highest compensated officers based on the Securities and Exchange Commission (SEC) disclosure rules. Due to changes in the applicable SEC disclosure rules, IRS guidance has interpreted "covered employee" to mean the principal executive officer and the three highest compensated officers as of the close of the tax year.

In the Mark: The provision eliminates the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit. Thus, such compensation is taken into account in determining the amount of compensation with respect to a covered employee for a taxable year that exceeds $1 million. The provision also revises the definition of "covered employee" to include the principal executive officer, the principal financial officer, and the three other highest paid employees. Under the modified definition, once an employee qualifies as a covered employee, the individual remains a covered employee for all future years.

JCT Estimate: This provision would increase revenues by $10.4 billion over 10 years.

3. Excise tax on excess tax-exempt organization executive compensation

Current Law: Under current law, publicly traded C corporations can deduct up to $1 million for compensation paid to chief executive officers and other certain highly paid officers. Current law also limits the deductibility of certain severance-pay ("parachute payments"). There is no excise tax or other limitation on the executive compensation or severance payments made by tax-exempt organizations. Under current law, there are reasonableness requirements and a prohibition against private inurement for executive compensation for tax-exempt entities. There is not, however, an excise tax under current law tied to the amount of compensation.

In the Mark: The provision would impose an excise tax of 20% on compensation in excess of $1 million paid to any of the five highest-paid employees of a tax-exempt organization. The tax would apply to the value of all remuneration paid for services, including cash and the cash-value of most benefits.

The excise tax would also apply to excess “parachute payments,” or payments in the nature of compensation that are contingent on an employee’s separation and, in present value, are at least three times the employee’s base compensation.

JCT Estimate: This provision would increase revenues by $3.6 billion over 10 years.

I. Insurance Reforms

1. Net operating losses of life insurance companies

Current Law: Under current law, a net operating loss (“NOL”) generally means the amount by which a taxpayer’s business deductions exceed its gross income. In general, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.

In the case of a life insurance company, present law allows a deduction for the operations loss carryovers and carrybacks to a taxable year, in lieu of the deduction for net operation losses allowed to other corporations. A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any taxable year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.

In the Mark: The provision repeals the operations loss deduction for life insurance companies and allows the NOL deduction under section 172. This provides the same treatment for losses of life insurance companies as for losses of other corporations. The NOL deduction is determined by treating the NOL for any taxable year generally as the excess of the life insurance deductions for such taxable year, over the life insurance gross income for such taxable year.

JCT Estimate: Estimate included in modification of net operating loss deduction described above.

2. Repeal of small life insurance company deduction

Current Law: Under current law, the small life insurance company deduction for any taxable year is 60% of so much of the tentative life insurance company taxable income (“LICTI”) for such taxable year as does not exceed $3 million, reduced by 15% of the excess of tentative LICTI over $3 million. The maximum deduction that can be claimed by a small company is $1.8 million, and a company with a tentative LICTI of $15 million or more is not entitled to any small company deduction. A small life insurance company for this purpose is one with less than $500 million of assets.

In the Mark: The provision repeals the small life insurance company deduction.

JCT Estimate: This provision would increase revenues by $200 million over 10 years.

3. **Adjustment for change in computing reserves**

Current Law: Under current law, a taxpayer may change its method of accounting under section 446 with the consent of the Secretary of the Treasury (or may be required to change its method of accounting by the Secretary). In such instances, a taxpayer generally is required to make an adjustment (a "section 481(a) adjustment") to prevent amounts from being duplicated in, or omitted from, the calculation of the taxpayer's income. Pursuant to IRS procedures, negative section 481(a) adjustments generally are deducted from income in the year of the change whereas positive section 481(a) adjustments generally are required to be included in income ratably over four taxable years.

However, per section 807(f), income or loss resulting from a change in the method of computing reserves is taken into account ratably over a 10-year period. The rule for a change in basis in computing reserves applies only if there is a change in basis in computing the federally prescribed reserve. Changes in the net surrender value of a contract are not subject to the 10-year spread because, apart from its use as a minimum in determining the amount of life insurance tax reserves, the net surrender value is not a reserve but a current liability.

In the Mark: This provision would require that income or loss resulting from a change in method of computing life insurance company reserves be taken into account consistent with IRS procedures, generally ratably over a four-year period, instead of over a 10-year period.

JCT Estimate: This provision will increase revenues by $1.3 billion over 10 years.

4. **Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account**

Current Law: Present law provides that any distribution to shareholders is treated as made (1) first out of the shareholders surplus account, to the extent thereof, (2) then out of the policyholders surplus account, to the extent thereof, and (3) finally, out of other accounts.

For taxable years beginning after December 31, 2004, and before January 1, 2007, the application of the rules imposing income tax on distributions to shareholders from the policyholders surplus account of a life insurance company were suspended. Distributions in those years were treated as first made out of the policyholders surplus account, to the extent thereof, and then out of the shareholders surplus account, and lastly out of other accounts.

In the Mark: The provision repeals section 815, the rules imposing income tax on distributions to shareholders from the policyholders surplus account of a stock life insurance company.

In the case of any stock life insurance company with an existing policyholders surplus account (as defined in section 815 before its repeal), tax is imposed on the balance of the account as of December 31, 2017. A life insurance company is required to pay tax on the balance of the account ratably over the first eight taxable years beginning after December 31, 2017. Specifically, the tax imposed on a life insurance company is the tax on the sum of a life insurance company's taxable income for the taxable year (but not less than zero) plus 1/8 of the balance of the existing policyholder's surplus account as of December 31, 2017. Thus, life insurance company losses are not allowed to offset the amount of the policyholders surplus account balance subject to tax.

JCT Estimate: This provision will increase revenues by less than $50 million over 10 years.

5. <u>Modification of proration rules for property and casualty insurance companies</u>

Current Law: Under current law, the taxable income of a property and casualty insurance company is determined as the sum of its gross income from underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions.

A proration rule applies to property and casualty insurance companies. In calculating the deductible amount of its reserve for losses incurred, a property and casualty insurance company must reduce the amount of losses incurred by 15% (the "proration rate") of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment or annuity contracts the company owns. This proration rule reflects the fact that reserves are generally funded in part from tax-exempt interest, from deductible dividends, and from other untaxed amounts.

In the Mark: This provision increases the proration rate to 26.25%, thereby reducing the deduction for losses incurred. The proration rate will be automatically adjusted in the future if the top corporate rate is changed, so that the product of the proration rate and the top corporate rate always equals 5.25 percent.

JCT Estimate: This provision would increase revenues by $2.2 billion over 10 years.

6. <u>Repeal of special estimated tax payments</u>

Current Law: Present law allows an insurance company required to discount its reserves an additional deduction that does not exceed the excess of (1) the amount of the undiscounted unpaid losses over (2) the amount of the related discounted unpaid losses, to the extent the amount was not deducted in a preceding taxable year. The provision imposes the requirement that a special loss discount account be established and maintained, and that special estimated tax payments be made. Unused amounts of special estimated tax payments are treated as a section 6655 estimated tax payment for the 16th year after the year for which the special estimated tax payment was made.

The total payments by a taxpayer, including section 6655 estimated tax payments and other tax payments, together with special estimated tax payments made under this provision, are generally the same as the total tax payments that the taxpayer would make if the taxpayer did not elect to have this provision apply, except to the extent amounts can be refunded under the provision in the 16th year.

In the Mark: The provision repeals section 847. Thus, the election to apply section 847, the additional deduction, special loss discount account, special estimated tax payment, and refundable amount rules of present law are eliminated. The entire balance of an existing account is included in income of the taxpayer for the first taxable year beginning after 2017, and the entire amount of existing special estimated tax payments are applied against the amount of additional tax attributable to this inclusion. Any special estimated tax payments in excess of this amount are treated as estimated tax payments under section 6655.

JCT Estimate: This provision would increase revenues by less than $50 million over 10 years.

7. <u>Capitalization of certain policy acquisition expenses</u>

Current Law: In the case of an insurance company, certain policy acquisition expenses for any taxable year, such as commissions, are required to be capitalized over 120 months. A special rule provides for 60-month amortization of the first $5 million of certain policy acquisition expenses, with a phase-out.

The expenses are determined as the portion of the insurance company's general deductions for the taxable year that does not exceed a specific percentage of the net premiums for the taxable year on each of three categories of insurance contracts: (1) 1.75% for annuity contracts; (2) 2.05% for group life insurance contracts; and (3) 7.7% for all other insurance contracts.

In the Mark: The provision extends the amortization period for specified policy acquisition expenses from a 120-month period to a 600-month period. The provision does not change the special rule providing for 60-month amortization of the first $5 million of specified policy acquisition expenses (with phase out). The provision provides that for annuity contracts, the percentage is 3.17; for group life insurance contracts, the percentage is 3.72; and for all other specified insurance contracts, the percentage is 13.97.

JCT Estimate: This provision would increase revenues by $23 billion over 10 years.

8. <u>Tax reporting for life settlement transactions, clarification of tax basis of life insurance contracts, and exception to transfer for valuable consideration rules</u>

Current Law: Under current law, an exclusion from federal income tax is provided for amounts received under a life insurance contract paid by reason of the death of the insured. Under rules known as 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 generally is limited. Under the limitation, the excludable amount may not exceed the sum of (1) the actual value of the consideration, and (2) the premiums or other amounts subsequently paid by the transferee of the contract.

In the Mark: This provision 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 payor in the case of the payment of reportable death benefits. The provision sets forth rules for determining the basis of a 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 provision 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.

The provision 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 includable in income.

JCT Estimate: This provision would increase revenues by $0.2 billion over 10 years.

J. Provisions Relating to Partnerships

1. <u>Tax gain on the sale of a partnership interest on look-through basis</u>

Current Law: Gain or loss from the sale or exchange of a partnership interest generally is treated as gain or loss from the sale or exchange of a capital asset. However, the amount of money and the fair market value of property received in the exchange that represent the partner's share of certain ordinary income-producing assets of the partnership give rise to ordinary income rather than capital gain.

A foreign person that is engaged in a trade or business in the United States is taxed on income that is "effectively connected" with the conduct of that trade or business ("effectively connected gain or loss"). Partners in a partnership are treated as engaged in the conduct of a trade or business within the United States if the partnership is so engaged. Any gross income derived by the foreign person that is not effectively connected with the person's U.S. business is not taken into account in determining the rates of U.S. tax applicable to the person's income from the business.

Among the factors taken into account in determining whether income, gain, or loss is effectively connected gain or loss are the extent to which the income, gain, or loss is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the income, gain, or loss (the "asset use" and "business activities" tests). In determining whether the asset use or business activities tests are met, due regard is given to whether such assets or such income, gain, or loss were accounted for through such trade or business. Thus, notwithstanding the general rule that source of gain or loss from the sale or exchange of personal property is generally determined by the residence of the seller, a foreign partner may have effectively connected income by reason of the asset use or business activities of the partnership in which he is an investor.

Under a 1991 revenue ruling, in determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the IRS applied the asset-use test and business activities test at the partnership level to determine the extent to which income derived from the sale or exchange is effectively connected with that U.S. business. Under the ruling, if there is unrealized gain or loss in partnership assets that would be treated as effectively connected with the conduct of a U.S. trade or business if those assets were sold by the partnership, some or all of the foreign person's gain or loss from the sale or exchange of a partnership interest may be treated as effectively connected with the conduct of a U.S. trade or business. However, a 2017 Tax Court case rejects the logic of the ruling and instead holds that, generally, gain or loss on sale or exchange by a foreign person of an interest in a partnership that is engaged in a U.S. trade or business is foreign-source.

In the Mark: Under the provision, gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The provision requires that any gain or loss from the hypothetical asset sale by the partnership be allocated to interests in the partnership in the same manner as non-separately stated income and loss.

JCT Estimate: This provision would increase revenues by $3.8 billion over 10 years.

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

Current Law: In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under section 754 to make basis adjustments, or the partnership has a substantial built-in loss immediately after the transfer.

If an election is in effect, or if the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner. These adjustments are to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest. The adjustments are intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner.

A substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property. Certain securitization partnerships and electing investment partnerships are not treated as having a substantial built-in loss in certain instances, and thus are not required to make basis adjustments to partnership property. For electing investment partnerships, in lieu of the partnership basis adjustments, a partner-level loss limitation rule applies.

In the Mark: The provision modifies the definition of a substantial built-in loss for purposes of section 743(d), affecting transfers of partnership interests. Under the provision, in addition to the present-law definition, a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.

JCT Estimate: This provision would increase revenues by $500 million over 10 years.

3. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss

Current Law: Under current law, a partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis (before reduction by current year's losses) of the partner's interest in the partnership at the end of the partnership taxable year in which the loss occurred.

Any disallowed loss is allowable as a deduction at the end of the first succeeding partnership taxable year, and subsequent taxable years, to the extent that the partner's adjusted basis for its partnership interest at the end of any such year exceeds zero (before reduction by the loss for the year).

The IRS has taken the position in a private letter ruling that the section 704(d) loss limitation on partner losses does not apply to limit the partner's deduction for its share of the partnership's charitable contributions. While the regulations relating to the section 704(d) loss limitation do not mention the foreign tax credit, a taxpayer may choose the foreign tax credit in lieu of deducting foreign taxes.

Section 1366(d) limits the losses and deductions which may be taken into account by a shareholder of an S corporation to the shareholder's basis in stock and debt of the corporation. For purposes of this limitation, the shareholder's pro rata share of charitable contributions and foreign taxes are taken into account by reason of the last sentence of section 1366(a)(1).

In the Mark: The provision modifies the section 704(d) loss limitation rule to provide that a partner's distributive share of items that are not deductible in computing the partnership's taxable income, and not properly chargeable to capital account, are allowed only to the extent of the partner's adjusted basis in its partnership interest at the end of the partnership taxable year in which the expenditure occurs. Thus, the section 704(d) loss limitation applies to a partner's distributive share of charitable contributions and foreign taxes.

JCT Estimate: This provision would increase revenues by $1.2 billion over 10 years.

K. Determination of Worker Classification and Information Reporting Requirements

Current Law: Under current law, the tax status of a worker is generally made under a common-law facts and circumstances test that seeks to determine whether the worker is subject to the control of the service recipient, not only as to the nature of the work performed, but also as to the circumstances under which it is performed. Various provisions under current law, however, specifically classify a worker as an employee or an independent contractor. Under a special safe harbor rule (section 530 of the Revenue Act of 1978), a service recipient may treat a worker as an independent contractor for employment tax purposes, even though the worker may be an employee, if the service recipient has a reasonable basis for treating the worker as an independent contractor and certain other requirements are met. Under current law, payments to service providers are required to be reported on Form 1099-MISC when they exceed $600 in a taxable year. Third-party settlement organizations are required to issue 1099-Ks for network transactions to participating payees where there are over 200 transactions and the dollar amount exceeds $20,000.

In the Mark: The provision would create a safe harbor based on objective tests, which if satisfied, would ensure that the service provider (worker) would be treated as an independent contractor, and neither the service recipient (customer) nor the internet platform or app facilitates the transactions and payments in the on-demand economy would be treated as the employer. The provision also would align the reporting rules for payments made to service providers by increasing the current threshold for Form 1099-MISC to $1,000, and by creating a general threshold of $1,000 for Form 1099-K issued by third-party settlement organizations, which would be expanded to include marketplace platforms engaged in the on-demand economy. An exception would be provided for 1099-Ks issued with respect to sales of goods under which reporting would be required once the number of transactions exceeds 50 or the dollar amount exceeds $5,000.

JCT Estimate: The safe harbor for worker classification would decrease revenues by $3.4 billion over 10 years. The change in reporting thresholds would increase revenues by $3.6 billion.

L. Tax-Exempt Organizations

1. <u>Excise tax based on investment private income of colleges and universities</u>

Current Law: Under current law, private foundations and certain charitable trusts are subject to a 2% excise tax on their net investment income, reduced to 1% by making distributions equal to the averages of their distributions from the previous five years plus 1%. The excise tax does not apply to public charities including colleges and universities, although many of these institutions have substantial investment income.

In the Mark: This provision would impose an excise tax equal to 1.4% on investment income of certain private colleges and universities. The provision would apply only to private colleges and universities with at least 500 tuition-paying students and with assets (other than those used directly in carrying out the institution's exempt purpose) of at least $250,000 per student. The number of students would be based on the daily average number of full-time equivalent students (full-time students and part-time students on an equivalent basis). Net investment income is gross investment income minus expenses to produce the investment (but disallowing the use of accelerated depreciation methods or percentage depletion).

JCT Estimate: This provision would increase revenues by $2.5 billion over 10 years.

2. <u>Name and logo royalties treated as unrelated business taxable income</u>

Current Law: Under current law, Section 501(a) exempts certain organizations from federal income tax. Such organizations include: (1) tax-exempt organizations described in section 501(c) (including among others section 501(c)(3) charitable organizations and section 501(c)(4) social welfare organizations); (2) religious and apostolic organizations described in section 501(d); and (3) trusts forming part of a pension, profit-sharing, or stock bonus plan of an employer described in section 401(a).

Section 115 excludes from gross income certain income of entities that perform an essential government function. The exemption applies to: (1) income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof, or the District of Columbia; or (2) income accruing to the government of any possession of the United States, or any political subdivision thereof.

In the Mark: The provision modifies the unrelated business income tax (UBIT) treatment of the licensing of an organization's name or logo generally to subject royalty income derived from such a license to UBIT. Specifically, the provision amends section 513 (regarding unrelated trades or businesses) to provide that any sale or licensing by an organization of any name or logo of the organization (including any trademark or copyright related to a name or logo) is treated as an unrelated trade or business that is regularly carried on by the organization. In addition, the provision amends section 512 (regarding unrelated business taxable income) to provide that income derived from any such licensing of a name or logo of the organization is included in the organization's gross unrelated business taxable income, notwithstanding the provisions of section 512 that otherwise exclude certain types of passive income (including royalties) from unrelated business taxable income.

JCT Estimate: This provision would increase revenues by $2.0 billion over 10 years.

3. <u>Unrelated business taxable income separately computed for each trade or business activity</u>

Current law: Under current law, income subject to UBIT is based on the gross income of any unrelated trade or business less the deductions directly connected with carrying on such activity. In cases where a tax-exempt organization conducts two or more unrelated trades or businesses, the unrelated business taxable income is the aggregate gross income of all the unrelated trades or businesses less the aggregate deductions allowed with respect to all such unrelated trades or businesses. As a result, losses generated by one unrelated trade or business may be used to offset income derived from another unrelated trade or business.

In the Mark: Losses from one unrelated trades or businesses may not be used to offset income derived from another unrelated trade or business. Gains and losses must be calculated and applied separately. Also, the NOL carry-forward rules would be conformed to new NOL rules applicable to for-profit companies.

JCT Estimate: This provision would increase revenues $3.2 billion over 10 years.

4. Repeal tax-exempt status for professional sports leagues

Current Law: Under current law, Section 501(c)(6) provides tax exempt status for business leagues and certain other organizations not organized for profit. A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. Such an organization may not have as its primary activity performing "particular services" for members. Contributions to these types of organizations are not deductible as charitable contributions; however, they may be deductible as trade or business expenses if ordinary and necessary in the conduct of the taxpayer's business. Many organizations known as "trade associations" may qualify for exempt status under this provision.

Since 1966, section 501(c)(6) has included language exempting from tax "professional football leagues (whether or not administering a pension fund for football players)." The Internal Revenue Service has interpreted this language as applying not only to professional football leagues, but to all professional sports leagues.

In the Mark: This provision strikes from section 501(c)(6) the phrase "professional football leagues (whether or not administering a pension fund for football players)." In addition, the provision amends section 501(c)(6) to provide affirmatively that section 501(c)(6) "shall not apply to any professional sports league (whether or not administering a pension fund for players)."

JCT Estimate: This provision would increase revenues by $0.1 billion over 10 years.

5. Modification of taxes on excess benefit transactions (intermediate sanctions)

Current Law: Under current law, disqualified persons and managers who engage in excess benefit transactions with tax-exempt organizations (other than private foundations) are subject to an excise tax on the amount of the economic benefit that exceeds the value of the consideration (including the performance of services) received for providing the benefit. A disqualified person (other than a manager acting only in that capacity) is subject to a 25-percent excise tax, and, if such tax is imposed, a manager who knowingly participated in the transaction (unless such participation was not willful and due to reasonable cause) is subject to a 10-percent excise tax. However, under Treasury regulations, a manager may avoid the excise tax for knowingly participating in an excess-benefit transaction if the manager relies on advice provided by an appropriate professional, including legal counsel, certified public accountants, and independent valuation experts.

Under Treasury regulations, a tax-exempt organization in certain cases may avail itself of a rebuttable presumption with respect to compensation arrangements and property transfers for purposes of determining if the excise tax applies. If the requirements of the rebuttable presumption are met, the IRS may overcome the presumption of reasonableness if it develops sufficient contrary evidence to rebut the comparability data relied upon by the authorized body.

In the Mark: Under the provision, the excise tax on excess-benefit transaction would be expanded to apply not only to public charities, but also to labor, agricultural, and horticultural organizations (under section 501(c)(5)) and business leagues, chambers of commerce, real-estate boards, and boards of trade (under section 501(c)(6)).

The provision would impose an excise tax of 10 percent on the tax-exempt organization when the excess-benefit excise tax is imposed on a disqualified person. The entity-level tax does not apply if the organization follows minimum standards of due diligence or other procedures to ensure that no excess benefit is provided by the organization to a disqualified person. The provision also eliminates the rebuttable presumption of reasonableness contained in the intermediate sanctions regulations.

JCT Estimate: This provision would have a negligible revenue effect.

6. Charitable deduction not allowed for amounts paid in exchange for college athletic event seating rights

Current Law: Under current law, in general, where a taxpayer receives or expects to receive a substantial return benefit for a payment to charity, the payment is not deductible as a charitable contribution. However, special rules apply to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. Specifically, the payor may treat 80 percent of a payment as a charitable contribution where: (1) the amount is paid to or for the benefit of an institution of higher education (as defined in section 3304(f)) described in section (b)(1)(A)(ii) (generally, a school with a regular faculty and curriculum and meeting certain other requirements), and (2) such amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.

In the Mark: The provision repeals section 170(l), which generally provides that a taxpayer may deduct 80 percent of certain payments to institutions of higher education in exchange for which the taxpayer receives the right to purchase tickets or seating at an athletic event of such an institution.

JCT Estimate: This provision would increase revenues by $1.9 billion over 10 years.

M. Retirement Savings

1. Conformity of contribution limits for employer-sponsored retirement plans

Current Law: In the case of a section 401(k) plan or a section 403(b) plan, specific annual limits apply to elective deferrals by an employee and additional annual limits apply to aggregate contributions for the employee. For 2017, elective deferrals are generally limited to the lesser of (1) $18,000 plus an additional $6,000 catch-up contribution limit for employees at least age 50 and (2) the employee’s compensation. If an employee participates in both a section 401(k) plan and a section 403(b) plan of the same employer, a single limit applies to elective deferrals under both plans. However, under a special rule, in the case of employees who have completed 15 years of service, additional elective deferrals are permitted under a section 403(b) plan maintained by an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches. In this case, the annual limit is increased by the least of (1) \$3,000, (2) \$15,000 reduced by the employee's additional elective deferrals for previous years, and (3) \$5,000 multiplied by the employee's years of service and reduced by the employee's elective deferrals for previous years.

For 2017, the limit on aggregate contributions to a qualified defined contribution plan (including a section 401(k) plan) or a section 403(b) plan is the lesser of (1) \$54,000 and (2) the employee's compensation. Because employees generally do not receive compensation for years after they have terminated employment, contributions generally cannot be made for former employees. However, under a special rule, employer contributions to a section 403(b) plan can be made for up to five years after termination of employment.

In the case of a governmental section 457(b) plan, all contributions are subject to a single limit, generally for 2017, the lesser of (1) \$18,000 plus an additional \$6,000 catch-up contribution limit for employees at least age 50 and (2) the employee's compensation. This limit is separate from the limit on elective deferrals to section 401(k) and section 403(b) plans. Thus, for example, if an employee participates in both a section 403(b) plan and a governmental section 457(b) plan of the same employer, the employee may contribute up to \$18,000 (plus \$6,000 catch-up contributions if at least age 50) to the section 403(b) plan and up to \$18,000 (plus \$6,000 catch-up contributions if at least age 50) to the section 457(b) plan. In addition, under a special rule, catch-up contributions may be made by an employee to a governmental section 457(b) for the last three years before attainment of normal retirement age. Additional contributions may be made up to the lesser of (1) two times the otherwise applicable dollar limit for the year (two times \$18,000 for 2017, or \$36,000) and (2) the employee's otherwise applicable limit for the year plus the amount by which the limit applicable to the employee for previous years exceeded the employee's deferrals for the previous years. If a higher limit applies to an employee for a year under this special rule than under the general catch-up rule (\$6,000 for 2017), the general catch-up rule does not apply for the year.

In the Mark: The provision applies a single aggregate limit to contributions for an employee in a governmental section 457(b) plan and elective deferrals for the same employee under a section 401(k) plan or a 403(b) plan of the same employer. Thus, the limit for governmental section 457(b) plans is coordinated with the limit for section 401(k) and 403(b) plans in the same manner as the limits are coordinated under present law for elective deferrals to section 401(k) and section 403(b) plans.

The provision repeals the special rules allowing additional elective deferrals and catch-up contributions under section 403(b) plans and governmental section 457(b) plans. Thus, the same limits apply to elective deferrals and catch-up contributions under section 401(k) plans, section 403(b) plans and governmental section 457(b) plans.

The provision repeals the special rule allowing employer contributions to section 403(b) plans for up to five years after termination of employment.

The provision also revises application of the limit on aggregate contributions to a qualified defined contribution plan or a section 403(b) plan (that is, the lesser of (1) $54,000 (for 2017) and (2) the employee's compensation). As revised, a single aggregate limit applies to contributions for an employee to any defined contribution plans, any section 403(b) plans, and any governmental section 457(b) plans maintained by the same employer, including any members of a controlled group or affiliated service group.

JCT Estimate: This provision would increase revenues by $1.7 billion over 10 years.

2. <u>Application of 10-percent early withdrawal tax to governmental section 457(b) plans</u>

Current Law: Tax-favored employer-sponsored retirement plans include a qualified retirement plan, a tax-sheltered annuity plan (referred to as a "section 403(b) plan"), and an eligible deferred compensation plan of a State or local government (referred to as a "governmental section 457(b) plan"). A simplified employee pension ("SEP") plan and SIMPLE IRA plan are also tax-favored employer-sponsored retirement plans under which the employer makes contributions to an individual retirement arrangement ("IRA") established for each of its employees.

In general, similar tax treatment applies to contributions to and distributions from these plans. Distributions are generally includible in income except to the extent attributable to after-tax contributions or qualified distributions from Roth accounts. In addition, unless an exception applies, a distribution from a qualified retirement plan, section 403(b) plan, or IRA (including a SEP or SIMPLE IRA) before age 59½ is subject to an additional tax (the "early withdrawal tax"). The early withdrawal tax is equal to 10 percent of the amount of the distribution that is includible in income (25 percent in the case of certain SIMPLE IRA distributions). The early withdrawal tax does not apply to distributions from governmental section 457(b) plans

In the Mark: Under the provision, unless an exception applies, the early withdrawal tax applies to a distribution from a governmental section 457(b) plan before age 59½ to the extent the distribution is includible in income.

JCT Estimate: This provision would decrease revenues by $300 million over 10 years.

3. <u>Elimination of catch-up contributions for high-wage employees</u>

Current Law: Account-based tax-favored employer-sponsored retirement plans include a qualified defined contribution plan, a tax-sheltered annuity plan (referred to as a section 403(b) plan), and an eligible deferred compensation plan of a State or local government (referred to as a governmental section 457(b) plan). A simplified employee pension ("SEP") plan and SIMPLE IRA plan are also tax-favored employer-sponsored retirement plans under which the employer makes contributions to an individual retirement arrangement ("IRA") established for each of its employees. For purposes of these plans, a self-employed individual is treated as an employee. In the case of an employee age 50 or older, the specified dollar amount is increased by a certain amount (generally $6,000 for 2017), allowing the employee to make additional "catch-up" contributions for the year

In the Mark: Under the provision, an employee may not make catch-up contributions for a year if the employee received wages of $500,000 or more for the preceding year.

JCT Estimate: This provision would increase revenues by $500 million over 10 years.

IV – INTERNATIONAL TAX REFORM

A. Establishment of a Participation Exemption System for Taxation of Foreign Income

1. Deduction for dividends received by domestic corporations from certain foreign corporations

Current Law: Generally, foreign income earned by a foreign subsidiary of a U.S. corporation is not subject to U.S. tax until it is distributed to the U.S. parent corporation as a dividend. Such dividends, minus credits for foreign taxes paid, are considered taxable income for the U.S. parent corporation.

In the Mark: If a U.S. corporation owns at least 10% of the voting stock in a foreign corporation, the foreign-source portion of dividends paid by the foreign corporation to the U.S. corporation are 100% exempt from U.S. tax.

JCT Estimate: This provision would reduce revenues by $215.6 billion over 10 years.

2. Special rules relating to sales or transfers involving specified 10-percent owned foreign corporations

Current Law: When a U.S. corporation sells or exchanges stock in a foreign subsidiary, the gain may be considered a dividend to the extent the foreign corporation has earnings and profits that have not already been subject to U.S. tax. If foreign business is conducted through a branch of a U.S. corporation rather than a foreign subsidiary, the corporation owes U.S. taxes on the foreign earnings and deducts losses as though they accrued directly to the U.S. corporation.

In the Mark: This provision requires a U.S. corporation to reduce the basis of its stock in foreign subsidiaries by the amount of any dividends received from the subsidiaries that are exempt from tax by the new dividends received deduction, but only for the purpose of determining losses on sales and exchanges of subsidiary stock. If a U.S. corporation transfers substantially all of the assets of a foreign branch to a foreign subsidiary corporation, the "transferred loss" amount (i.e., the losses incurred by the foreign branch over certain taxable income earned by the foreign branch) is generally included in the U.S. corporation's gross income.

JCT Estimate: This provision would raise revenues by $11.3 billion over 10 years.

3. Treatment of deferred foreign income upon transition to participation exemption system of taxation

Current Law: : Generally, foreign income earned by a foreign subsidiary of a U.S. corporation is not subject to U.S. tax until it is distributed to the U.S. parent corporation as a dividend. Such dividends, minus credits for foreign taxes paid, are considered taxable income for the U.S. corporation.

In the Mark: For the last taxable year beginning before the dividend exemption takes effect, a U.S. corporation that is a 10-percent shareholder of a foreign corporation must include in income its pro rata share of the undistributed, non-previously-taxed post-1986 foreign earnings of the corporation. The subpart F inclusion is taxed at rates of 10 percent for earnings attributable to liquid assets and 5 percent for other earnings.

Taxpayers subject to this deemed repatriation may elect to pay the net tax liability in eight installments in the following amounts: installments one through five in an amount equal to eight percent of the net tax liability; a sixth installment of 15 percent of the net tax liability; the seventh is 20 percent and the eighth, 25 percent. If an installment is paid on time, it does not incur interest.

There is a special rule for S corporations. Their shareholders may elect to maintain deferral on such foreign income until the S corporation changes its status, sells substantially all its assets, ceases to conduct business, or the electing shareholder transfers its S corporation stock.

JCT Estimate: This provision would raise revenues by $190 billion over 10 years.

B. Rules Related to Passive and Mobile Income

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

Current Law: : Generally, foreign income earned by a foreign subsidiary of a U.S. corporation is not subject to U.S. tax until it is distributed to the U.S. parent corporation as a dividend. Such dividends, minus credits for foreign income taxes paid, are currently considered taxable income for the U.S. corporation.

The main exception to deferral of U.S. tax is what is commonly called subpart F income (certain foreign insurance income, certain passive investment income, and specified kinds of business income, as well as certain investments in U.S. property). A U.S. parent is generally subject to current U.S. tax on subpart F income earned by its foreign subsidiaries, less any foreign income taxes paid on such income.

In the Mark: A U.S. shareholder of a controlled foreign corporation must currently include in income its global intangible low-taxed income in a manner similar to how it includes subpart F income. Global intangible low-taxed income is measured as the excess of the U.S. shareholder's aggregate net income over a routine return of 10% on its pro-rata share of the depreciable tangible property of the controlled foreign corporation(s). Global intangible low taxed income does not include effectively connected income, subpart F income, foreign oil and gas income, or certain related party payments. Global intangible low-taxed income is taxed at a rate of 10%.

Foreign tax credits are allowed for foreign income taxes paid with respect to global intangible low-taxed income but are limited to 80 percent of the foreign income taxes paid and are not allowed to be carried back or forward to other tax years.

JCT Estimate: This provision would increase revenues by $115.5 billion over 10 years.

2. <u>Deduction for foreign-derived intangible income</u>

Current Law: A U.S. corporation's taxable income is taxed at rates ranging from 15 percent to a top rate of 35 percent. This is true whether the corporation's income is derived from tangible property or intangible property.

In the Mark: A U.S. corporation is allowed a preferential tax rate of 12.5% on its foreign-derived intangible income earned in the United States. Foreign derived intangible income is calculated in a manner similar to the global intangible low taxed income.

JCT Estimate: This provision would reduce revenues by $86.4 billion over 10 years

3. <u>Special rules for transfers of intangible property from controlled foreign corporations to United States shareholders</u>

Current Law: If a U.S. corporation receives a distribution of earnings and profits from a foreign corporation, whether of cash or property, the distribution is immediately subject to U.S. tax. If the distribution is of property, then the amount of taxable income to the U.S. corporation is the fair market value of the property at the time of the distribution to the extent that the foreign corporation has earnings and profits.

In the Mark: This provision allows for tax-free transfers of intangible property, such as patents, inventions, formulas, processes, designs, patterns, and know-how, from a controlled foreign corporation to its U.S. parent corporation.

JCT Estimate: This provision would reduce revenues by $34.1 billion over 10 years.

C. Other Modifications to Subpart F Provisions

1. **Elimination of inclusion of foreign base company oil-related income.**

Current Law: Under the subpart F rules, the United States generally taxes the 10-percent U.S. shareholders of a CFC on their pro rata shares of certain income of the CFC (referred to as "subpart F income"), without regard to whether the income is distributed to the shareholders. In effect, the United States treats the 10-percent U.S. shareholders of a CFC as having received a current distribution of the corporation's subpart F income. Subpart F income consists of foreign base company income, insurance income, and certain income relating to international boycotts and other violations of public policy.

Foreign base company income consists of foreign personal holding company income, which includes passive income such as dividends, interest, rents, and royalties, and a number of categories of income from business operations, including foreign base company sales income, foreign base company services income, and foreign base company oil-related income.

In the Mark: The provision eliminates foreign base company oil-related income as a category of foreign base company income.

JCT Estimate: This provision would reduce revenues by $4 billion over 10 years.

2. **Inflation adjustment of de minimis exception for foreign base company income**

Current Law: Under a de minimis rule, if the sum of a controlled foreign corporation's foreign base company income and gross insurance income for the tax year is less than the lesser of 5% of gross income or $1,000,000, then none of the CFC's gross income for the tax year is treated as foreign base company income or insurance income.

In the Mark: This provision indexes the $1 million de minimis amount for inflation, with all increases rounded to the nearest multiple of $50,000.

JCT Estimate: This provision would reduce revenues by $400 million over 10 years.

3. **Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment.**

Current law: Prior to 2005, subpart F income included foreign base company shipping income. Foreign base company shipping income generally included income derived from the use of an aircraft or vessel in foreign commerce, the performance of services directly related to the use of any such aircraft or vessel, the sale or other disposition of any such aircraft or vessel, and certain space or ocean activities. However, for taxable years beginning after 1975 and before 1987, subpart F income did not include foreign base company shipping income to the extent that such shipping income was reinvested during the taxable year in certain qualified shipping investments. To the extent that, in a subsequent year, a net decrease in qualified shipping investments occurred, however, the amount of previously excluded subpart F income equal to such decrease is itself considered subpart F income under section 955. Therefore, withdrawal of previously excluded subpart F income from qualified shipping investments triggers an equivalent increase in the subpart F income of the CFC.

In the Mark: The provision repeals section 955. As a result, a U.S. shareholder in a CFC that invested its previously excluded subpart F income in qualified foreign base company shipping operations is no longer required to include in income a pro rata share of the previously excluded subpart F income when the CFC decreases such investments.

JCT Estimate: This provision would reduce revenues by less than $50 million over 10 years.

4. <u>Modification of stock attribution rules for determining status as a controlled foreign corporation.</u>

Current Law: A U.S. parent of a CFC is subject to U.S. tax on its share of the CFC's subpart F income, even if no income is distributed to the U.S. parent. A foreign subsidiary is considered a CFC if one or more U.S. persons, each of which owns at least 10% of the foreign subsidiary, own more than 50% of the subsidiary's stock. A U.S. person may be considered to constructively own stock held by related persons and shareholders, but a U.S. corporation generally cannot be treated as constructively owning the stock of a foreign shareholder.

In the Mark: This provision changes the ownership attribution rules so that certain stock directly owned by a foreign person is attributed to a related U.S. person for purposes of determining whether a foreign corporation is a CFC or a U.S. person is a U.S. shareholder.

JCT Estimate: Estimate reflected in dividends received deduction above.

5. <u>Modification of the definition of U.S. shareholder</u>

Current Law: A U.S. shareholder of a foreign corporation is a person who owns or is considered to own 10% or more of the total combined voting power of all classes of stock entitled to vote.

In the Mark: The provision expands the definition of U.S. shareholder to include any U.S. person who owns 10 percent or more of the total **value** of shares of all classes of stock of a foreign corporation.

JCT Estimate: This provision would increase revenues by $1.4 billion over 10 years.

6. <u>Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply.</u>

Current Law: Current law requires a corporation to be a CFC for an uninterrupted period of at least 30 days in order for a U.S. shareholder to have a subpart F income inclusion with respect to the corporation.

In the Mark: The provision eliminates the requirement that a corporation must be controlled for an uninterrupted period of 30 days before subpart F inclusions apply.

JCT Estimate: This provision would increase revenues by $400 million over 10 years.

7. Look-thru rule for related controlled foreign corporations made permanent

Current Law: Current law generally subjects a 10% U.S. shareholder (taking into account a number of attribution and constructive ownership rules) of a CFC generally subject to current U.S. tax on its share of a CFC's subpart F income. However, until 2020, Section 954(c)(6) of the Code provides a "look-through" rule in which passive income will generally not be subject to current U.S. taxation if the income was received by a CFC from a related CFC (provided such income was not subpart F income or income effectively connected with the conduct of a U.S. trade or business).

In the Mark: This provision makes permanent the CFC look-through rule.

JCT Estimate: This provision would reduce revenues by $11.8 billion over 10 years.

8. Corporations eligible for deduction for dividends from CFCs exempt from subpart F inclusion for investment in U.S. property.

Current Law: The 10-percent U.S. shareholders of a CFC are required to include currently in income for U.S. tax purposes their pro rata shares of the corporation's untaxed earnings invested in certain items of U.S. property.

In the Mark: The requirement in subpart F that U.S. shareholders recognize income when earnings are repatriated in the form of increases in investment by a CFC in U.S. property is amended to provide an exception for domestic corporations that are U.S. shareholders in the CFC either directly or through a domestic partnership.

JCT Estimate: This provision would reduce revenues by $2 billion over 10 years.

D. Prevention of Base Erosion

1. Denial of deduction for interest expense of United States shareholders which are members of worldwide affiliated groups with excess domestic indebtedness

Current Law: Domestic corporations can reduce their U.S. tax liability through the use of deductible interest payments. The high U.S. corporate tax rate creates an incentive to locate debt in the United States.

In the Mark: The provision addresses base erosion that results from excessive and disproportionate borrowing in the United States by limiting the deductibility of interest paid or accrued by U.S. corporations that are members of a worldwide affiliated group. For any domestic corporation that is a member of a worldwide affiliated group, the provision reduces the deduction for interest paid or accrued by the corporation by the product of the net interest expense of the domestic corporation multiplied by the debt-to-equity differential percentage of the worldwide affiliated group.

JCT Estimate: This provision would increase revenues by $8.8 billion over 10 years.

2. <u>Limitations on income shifting through intangible property transfers</u>

Current Law: The meaning of intangible property is unclear although it is a lynchpin of the tax law, particularly to work out the allocation of income and deductions among taxpayers under the transfer pricing rules of section 482 to prevent shifting of income across borders.

In the Mark: The provision addresses recurring definitional and methodological issues that have arisen in controversies in transfers of intangible property for purposes of sections 367(d) and 482, both of which use the statutory definition of intangible property in section 936(h)(3)(B). The provision revises that definition and confirms the authority to require certain valuation methods.

JCT Estimate: This provision would increase revenues by $1.3 billion over 10 years

3. <u>Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities</u>

Current Law: Taxpayers currently use a variety of cross-border hybrid arrangements to claim deductions without inclusions in any country or to claim multiple deductions for the same payment in different countries.

In the Mark: The provision denies 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 to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. 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).

JCT Estimate: Estimate is reflected in dividends received deduction above.

4. <u>Termination of special rules for domestic international sales corporations</u>

Current Law: A domestic international sales corporation ("DISC") is a domestic corporation that satisfies the following conditions: 95 percent of its gross receipts must be qualified export receipts; 95 percent of the sum of the adjusted bases of all its assets must be attributable to the sum of the adjusted bases of qualified export assets; the corporation must have no more than one class of stock; the par or stated value of the outstanding stock must be at least $2,500 on each day of the taxable year; and, an election must be in effect to be taxed as a DISC. A DISC is generally not subject to corporate-level tax and offers limited deferral of tax liability to its shareholders.

In the Mark: The provision repeals the special Code rules for domestic international sales corporations.

JCT Estimate: This provision would increase revenues by $5.3 billion over 10 years.

5. <u>Dividends from surrogate foreign corporations not eligible for reduced rate on dividends</u>

Current Law: Individual shareholders are entitled to a reduced rate of tax on qualified dividend income. The term qualified dividend income includes dividends from certain foreign corporations.

In the Mark: An individual shareholder who receives a dividend from a corporation which is a surrogate foreign corporation as defined in section 7874(a)(2)(B) (that is, a U.S. corporation that inverts to become a foreign corporation, other than a foreign corporation which is treated as a domestic corporation under section 7874(b)) is not entitled to the lower rates on qualified dividend income provided in section 1(h).

JCT Estimate: This provision would increase revenues by $700 million over 10 years.

E. Modifications Related to the Foreign Tax Credit System

1. <u>Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis</u>

Current Law: A domestic corporation that owns at least 10 percent of the voting stock of a foreign corporation is allowed a "deemed-paid" credit for foreign income taxes paid by the foreign corporation that the domestic corporation is deemed to have paid when the related income is distributed as a dividend or is included in the domestic corporation's income under the anti-deferral rules.

In the Mark: The provision repeals the deemed-paid credit with respect to dividends received by a domestic corporation which owns 10 percent or more of the voting stock of a foreign corporation. A deemed-paid credit is provided with respect to any income inclusion under subpart F. The deemed-paid credit is limited to the amount of foreign income taxes properly attributable to the subpart F inclusion.

JCT Estimate: Estimate is reflected in dividends received deduction above.

2. <u>Separate foreign tax credit limitation basket for foreign branch income</u>

Current Law: The foreign tax credit limitation is applied separately to passive category income and general category income. Passive category income includes passive income, such as portfolio interest and dividend income. All other income is in the general category.

In the Mark: The provision requires foreign branch income to be allocated to a specific foreign tax credit basket. Foreign branch income is the business profits of a United States person which are attributable to one or more qualified business units (QBUs), in one or more foreign countries.

JCT Estimate: Estimate is reflected in the inclusion for global intangible low-taxed income above.

3. <u>Acceleration of election to allocate interest, etc., on a worldwide basis</u>

Current Law: Current law allows corporations a deduction for interest to be apportioned based on the ratio of the corporation's foreign or domestic assets (as applicable) to its worldwide assets. Generally speaking, the rules of apportioning the deductions among affiliated groups exclude foreign corporations. These rules were modified by legislation in 2004 to permit a U.S.-affiliated group to apportion the interest expense of the members of the U.S.-affiliated group on a worldwide-group basis (that is, as if all domestic and foreign affiliates are a single corporation). But, the modification has been delayed by statute until 2021.

In the Mark: This provision accelerates the effective date of the worldwide interest allocation rules to taxable years beginning after December 31, 2017.

JCT Estimate: This provision will reduce revenues by $2 billion over 10 years.

4. <u>Source of income from sales of inventory determined solely on basis of production activities</u>

Current Law: Income from the sale of inventory property that a taxpayer produces (in whole or in part) in the United States and sells outside the United States, or that a taxpayer produces (in whole or in part) outside the United States and sells in the United States, is treated as partly U.S.-source and partly foreign-source.

In the Mark: Under this provision, gains, profits, and income from the sale or exchange of inventory property produced partly in, and partly outside, the United States is allocated and apportioned on the basis of the location of production with respect to the property. For example, income derived from the sale of inventory property to a foreign jurisdiction is sourced wholly within the United States if the property was produced entirely in the United States, even if title passage occurred elsewhere. Likewise, income derived from inventory property sold in the United States, but produced entirely in another country, is sourced in that country even if title passage occurs in the United States. If the inventory property is produced partly in, and partly outside, the United States, the income derived from its sale is sourced partly in the United States.

JCT estimate: This provision would increase revenues by $500 million over 10 years.

F. Inbound Transactions

1. Base erosion and anti-abuse tax

Current law: Currently, foreign-owned U.S. subsidiaries are able to reduce their U.S. tax liability by making deductible payments to a foreign parent (or foreign affiliates). This often results in earnings stripping when deductible related-party payments are subject to little or no U.S. withholding tax. Foreign parents often take advantage of these deductions through the use of interest, royalties, management fees, or reinsurance payments from the U.S. subsidiary.

In the Mark: This provision requires all U.S. corporate taxpayers with 1) annual gross receipts in excess of $500 million and 2) deductible foreign related-party payments to pay additional corporate tax, in certain circumstances. The base erosion anti-abuse tax is imposed if 10% of the modified taxable income (generally, taxable income plus deductible foreign related-party payments) of the U.S. corporation exceeds the U.S. corporation’s regular tax liability for the year. Deductible foreign related-party payments do not include cost of goods sold (which is not a deduction but rather a reduction of gross income). U.S. corporations with foreign-related party payments of less than 4% of their total expenses are not subject to the tax. The provision allows for a reduction of liability for this anti-abuse tax for a certain percentage of the U.S. corporation’s net operating loss carryforwards and its research and development tax credits.

JCT Estimate: This provision would increase revenues by $123.5 billion over 10 years.

G. Other Provisions

1. Taxation of passenger cruise gross income of foreign corporations and nonresident alien individuals

Current Law: Source rules generally provide that income from furnishing transportation that both begins and ends in the United States is U.S.-source income, and 50-percent of income attributable to transportation that either begins or the ends in the United States is treated as U.S.-source income. However, to the extent that the operator of a shipping or cruise line is foreign, its ownership structure and the maritime law applicable for determining what constitutes international shipping as well as specific income tax provisions combine to create an industry-specific departure from the rules generally applicable.

In the Mark: This provision creates a category of income defined as passenger cruise gross income, provides specific rules for determining the extent to which such income is effectively connected with the conduct of a trade or business in the United States, and removes such income from eligibility for reciprocal exemptions.

JCT Estimate: This provision would increase revenues by $700 million over 10 years.

2. Restriction on insurance business exception to PFIC rules

Current Law: Under current law, U.S. shareholders of a passive foreign investment company (PFIC) may be taxed currently on the PFIC's earnings. A PFIC is defined as any foreign corporation (1) 75 percent or more of the gross income of which is passive, or (2) at least 50 percent of the assets of which produce passive income. Among other exceptions, passive income does not include any income that is derived in the active conduct of an insurance business if the PFIC is predominantly engaged in an insurance business and would be taxed as an insurance company were it a U.S. corporation.

In the Mark: Under the provision, the PFIC exception for insurance companies would be amended to apply only if the foreign corporation would be taxed as an insurance company were it a U.S. corporation and if loss and loss adjustment expenses, unearned premiums, and certain reserves constitute more than 25 percent of the foreign corporation's total assets (or 10 percent if the corporation is predominantly engaged in an insurance business and the reason for the percentage falling below 25 percent is solely due to temporary circumstances).

JCT Estimate: This provision would increase revenues by $1.1 billion over 10 years.

3. <u>Repeal of fair market value method of interest expense apportionment</u>

Current Law: Currently, members of a U.S. affiliated group can allocate interest expense on the basis of the fair market value of assets for purposes of section 864(e).

In the Mark: The provision prohibits members of a U.S. affiliated group from allocating interest expense on the basis of the fair market value of assets for purposes of section 864(e), and requires that members allocate interest expense based on the adjusted tax basis of assets.

JCT Estimate: This provision would increase revenues by $200 million over 10 years.