

CLEARY GOTTLIB

November 16, 2017

Tax Cuts & Jobs Act: Key Provisions

Comparison of House Bill (*released 11/2/17; amended 11/3, 11/6 and 11/9*) **and Senate Bill** (*description released 11/9/17; amended 11/14*)

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Corporate Rates	<ul style="list-style-type: none"> • Corporate tax rate lowered to 20% beginning in 2018 • Dividends received deduction for less-than-80% owned U.S. corporations reduced such that effective tax rate on these dividends is unchanged by the lower corporate tax rate • AMT repealed 	<ul style="list-style-type: none"> • Corporate tax rate lowered to 20% beginning in 2019 • Dividends received deduction for less-than-80% owned U.S. corporations reduced such that effective tax rate on these dividends is unchanged by the lower corporate tax rate • AMT repealed beginning in 2018
Individual Rates	<ul style="list-style-type: none"> • Existing 8 rate brackets changed to 4 new brackets; maximum rate of 39.6% retained for top bracket • AMT repealed 	<ul style="list-style-type: none"> • 8 individual rate brackets retained, with slightly lower rates; maximum rate for top bracket reduced to 38.5% • AMT repealed • Rate reductions, AMT repeal, and other individual provisions expire after 2025
Pass-thru Rate	<ul style="list-style-type: none"> • Individuals investing in pass-thru entities taxed at 25% rate on 100% of passive business income and 30% (or less) of active business income (with a potential election to apply a different percentage based on partnership depreciable assets) 	<ul style="list-style-type: none"> • Individuals may deduct 17.4% of domestic trade or business income from a partnership, S corporation or sole proprietorship; generally excluding income from services businesses and remuneration for services • However, the deduction is generally capped at the taxpayer's allocable share of 50% of the W-2 wages paid by the partnership, S corporation or sole proprietorship • 17.4% deduction expires after 2025

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Deduction for State and Local Taxes	<ul style="list-style-type: none"> • State and local taxes are generally not deductible; however: <ul style="list-style-type: none"> ○ State and local property taxes are deductible up to \$10,000; and ○ State and local taxes incurred in connection with a trade or business by a pass-thru entity (e.g. sales taxes) are deductible 	<ul style="list-style-type: none"> • State and local income taxes are not deductible • State and local property and sales taxes are deductible to the extent incurred in connection with a trade or business • Changes to SALT deductions expire after 2025
Expensing	<ul style="list-style-type: none"> • 100% of cost of qualified property acquired and placed in service before 2023 is immediately deductible • “Qualified property” is depreciable tangible property; excludes stock, intangibles, real estate, and any other property used in a real estate business • The maximum annual amount of the immediate deduction available for qualified property acquired by small businesses would be increased to \$5m (from \$500k) for taxable years through 2022 • Depreciation of real property unchanged 	<ul style="list-style-type: none"> • 100% of cost of qualified property acquired and placed in service before 2023 is immediately deductible • “Qualified property” is depreciable tangible property; excludes stock, intangibles, real estate, and public utility property • The maximum annual amount of the immediate deduction available for qualified property acquired by small businesses would be increased to \$1m (from \$500k) • Recovery period for depreciation of real property reduced to 25 years (from 39 under current law)
NOLs	<ul style="list-style-type: none"> • For NOLs arising in 2018 and later, carrybacks are repealed and carryforwards are indefinite (with inflation adjustment) • Beginning in 2018, NOLs are only deductible against 90% of taxable income, no matter when the NOLs arose (<i>i.e.</i> no grandfathering) 	<ul style="list-style-type: none"> • For NOLs arising in 2018 and later, carrybacks are repealed and carryforwards are indefinite • For NOLs arising in 2018 and later, for taxable years 2018 through 2023, NOLs are deductible only against 90% of taxable income (pre-2018 NOLs are grandfathered) • Beginning in 2024, NOLs are deductible only against 80% of taxable income

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Mortgage Interest	<ul style="list-style-type: none"> For debt incurred after 11/2/17, mortgage interest deduction is limited to \$500k of debt and one principal residence 	<ul style="list-style-type: none"> Deduction for interest on acquisition indebtedness retained and unchanged; deduction for interest on home equity indebtedness repealed. Repeal of deduction for home equity interest expires after 2025
Itemized Deductions	<ul style="list-style-type: none"> Limitations on itemized deductions (3% phase-out and 80% cap) are repealed Many miscellaneous itemized deductions are repealed, but deductions for investment interest and investment advisory fees (among others) are retained, subject to the 2% floor 	<ul style="list-style-type: none"> Limitations on itemized deductions (3% phase-out and 80% cap) are repealed All miscellaneous itemized deductions (including investment interest and investment advisory fees) are repealed Changes to itemized deductions expire after 2025
Accounting Methods	<ul style="list-style-type: none"> No change from current law 	<ul style="list-style-type: none"> Income – such as credit card fees – is taken into account for tax purposes as it is taken into account for book purposes
Interest Expense Deductions	<ul style="list-style-type: none"> “Worst of” two rules will apply to all debt outstanding on 1/1/18 (no grandfathering) First Rule: deduction for net business interest expense limited to 30% of EBITDA; disallowed interest can be carried forward for 5 years <ul style="list-style-type: none"> Interest incurred in a real property business not subject to this limitation Second Rule: in multinational groups, U.S. borrowers’ deduction for net interest expense capped at 110% of the U.S. share of the group’s overall EBITDA 	<ul style="list-style-type: none"> “Worst of” two rules will apply to all debt outstanding on 1/1/18 (no grandfathering) First Rule: deduction for net business interest expense limited to 30% of adjusted taxable income; disallowed interest can be carried forward indefinitely <ul style="list-style-type: none"> At taxpayer’s election, interest incurred in a real property business not subject to this limitation “Adjusted taxable income” means taxable income without regard to non-business income/deductions, business interest, the 17.4% deduction for pass-thru income, and NOL deductions Second Rule: in multinational groups, U.S. borrowers’ deduction for net interest expense capped at 110% of the U.S. share of the group’s overall leverage

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Carried Interest	<ul style="list-style-type: none"> For capital gains recognized with respect to services-related investment partnership profits interests, 3-year holding period to qualify as long-term capital gains; otherwise, characterized as short-term capital gains 	<ul style="list-style-type: none"> No change from current law
Gain on Sale of Partnership Interest	<ul style="list-style-type: none"> No change from current law 	<ul style="list-style-type: none"> When a foreign person sells an interest in a partnership that is engaged in a U.S. trade or business, a portion of the gain is taxable 10% gross basis withholding tax applies to foreign individual or corporate sellers of a partnership interest (with secondary liability on the partnership to withhold if transferee does not)
UBTI of Governmental Entities	<ul style="list-style-type: none"> State pension plans and certain other state and local governmental entities are subject to tax on UBTI Applies to taxable years beginning after 12/31/17, with no grandfathering for existing investments 	<ul style="list-style-type: none"> No change from current law
Deferred Compensation	<ul style="list-style-type: none"> New deferral provision for certain types of broad-based employee equity may apply for private companies Limit on deduction for compensation in excess of \$1m applies to expanded group of covered employees; no performance-based compensation exception 	<ul style="list-style-type: none"> New deferral provision for certain types of broad-based employee equity may apply for private companies Limit on deduction for compensation in excess of \$1m applies to expanded group of covered employees; no performance-based compensation exception; grandfathering available for compensation vested prior to 2017 under existing contracts
Estate and Gift Tax	<ul style="list-style-type: none"> Beginning in 2018, applies to estates over \$10m (up from \$5m) Repealed entirely after 2023 Basis step-up at death retained 	<ul style="list-style-type: none"> Beginning in 2018, applies to estates over \$10m (up from \$5m) Basis step-up at death retained Changes to estate tax expire after 2025

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Deemed Repatriation	<ul style="list-style-type: none"> • One-time transition tax is imposed on earnings of non-U.S. subsidiaries – 14% on liquid assets; 7% on illiquid assets • Taxpayers can elect to pay the tax over 8 years • Tax applies to <i>all</i> 10% U.S. shareholders (not just corporations); rate unclear for individuals 	<ul style="list-style-type: none"> • One-time transition tax is imposed in 2017 on earnings of non-U.S. subsidiaries – 10% on liquid assets; 5% on illiquid assets • Taxpayers can elect to pay the tax over 8 years • Tax applies to <i>all</i> 10% U.S. shareholders (not just corporations); rate unclear for individuals • Special recapture (at 35% rate) for corporations that expatriate within 10 years • Election available to preserve NOLs
Participation Exemption	<ul style="list-style-type: none"> • Dividends received by a U.S. corporation from a 10%+ foreign subsidiary are exempt from tax, if attributable to foreign source income • Exemption does not apply to dividends received by non-corporate taxpayers, or to gain from the sale of shares of foreign subsidiaries • 6-month holding period requirement to qualify for exemption • Section 956 repealed with respect to U.S. corporate shareholders 	<ul style="list-style-type: none"> • Dividends received by a U.S. corporation from a 10%+ foreign subsidiary are exempt from tax, if attributable to foreign source income • Exemption does not apply to hybrid dividends (deductible by the foreign subsidiary) or to dividends/gains received by non-corporate taxpayers • 1-year holding period requirement to qualify for the exemption • Section 956 repealed with respect to U.S. corporate shareholders
CFC Attribution Rules	<ul style="list-style-type: none"> • Attribution rules expanded to allow “downwards attribution” from foreign persons to U.S. persons, which could cause foreign corporations to be treated as CFCs when significantly less than 50% of the equity is directly or indirectly owned by U.S. shareholders 	<ul style="list-style-type: none"> • Attribution rules expanded to allow “downwards attribution” from foreign persons to U.S. persons, which could cause foreign corporations to be treated as CFCs when significantly less than 50% of the equity is directly or indirectly owned by U.S. shareholders • U.S. shareholder status expanded to ownership by 10% of value, not just voting power

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Base Erosion: Deductible Payments to Foreign Affiliates	<p><i>Excise Tax/ECI Election:</i></p> <ul style="list-style-type: none"> • Starting in 2019, 20% excise tax on deductible payments from U.S. corporations and branches to foreign affiliates, excluding certain securities, commodities and service transactions, as well as interest and other payments • Taxpayers can elect to avoid the excise tax by treating the outbound payments, less deemed expenses, as ECI to the foreign recipient, with 80% foreign tax credit available • Groups with aggregate outbound payments of \$100 million or less are exempted from the excise tax 	<p><i>Base Erosion Anti-Abuse Tax:</i></p> <ul style="list-style-type: none"> • In 2018 through 2025, corporations and REITs owe a 10% tax on the amount by which deductible payments to foreign affiliates exceed taxable income (determined taking into account research credits but no other credits) <ul style="list-style-type: none"> ○ In 2026 and later years, the rate increases to 12.5% on the amount by which deductible payments to foreign affiliates exceed taxable income (determined taking into account all credits) • Certain payments for services are excluded, but there are no explicit exclusions for interest or financial transactions • Applies only to corporations (including S corporations) and REITs with at least \$500m in annual gross receipts and for which deductible payments to foreign affiliates represent at least 4% of total deductions • Includes foreign corporations and REITs, if ECI meets the gross receipts test

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Base Erosion: CFC Excess Returns	<p><i>Foreign High Returns:</i></p> <ul style="list-style-type: none"> • U.S. shareholders of CFCs are subject to current tax on 50% of a CFC's net income (excluding ECI, subpart F income, active financing income, and certain other amounts) in excess of a deemed rate of return on the CFC's tangible assets, with 80% foreign tax credit available • Deemed rate of return is reduced by the CFC's interest expense • A CFC would need to pay tax at an effective rate of at least 12.5% in order to avoid this rule 	<p><i>Global Intangible Low-Taxed Income:</i></p> <ul style="list-style-type: none"> • U.S. shareholders of CFCs are subject to current tax on 62.5% of a CFC's net income (excluding ECI, subpart F income, and certain other amounts) in excess of a deemed rate of return on the CFC's tangible assets, with 80% foreign tax credit available (but subject to special rules) <ul style="list-style-type: none"> ○ In light of 11/14/17 Senate amendment, the percentage of income subject to this rule is unclear; however it seems that different rates will apply for 2018-2025 and for 2026 and later years ○ Deemed rate of return not reduced by interest expense ○ A CFC would need to pay foreign tax at an effective rate of at least 15.6% in order to avoid this rule (though this may be different as a result of the 11/14/17 Senate amendment, which is unclear on this point) • Inclusion amount further reduced by 37.5% of the U.S. shareholder's foreign-derived intangible income in 2018 through 2025, and by 21.875% of foreign-derived intangible income in 2026 and later years • Also, CFCs may distribute appreciated intangible property to U.S. shareholders before 2021 without triggering current tax on the built-in gain
Base Erosion: Outbound Transfers of Intangibles	<ul style="list-style-type: none"> • No change from current law 	<ul style="list-style-type: none"> • Outbound transfers of workforce in place, goodwill (foreign and domestic), and going concern value are subject to tax under section 367(d)

<u>Topic</u>	<u>House Bill</u>	<u>Senate Bill</u>
Base Erosion: Hybrid Payments	<ul style="list-style-type: none">• No change from current law	<ul style="list-style-type: none">• Interest and royalty payments are not deductible if amount is not taxable to recipient (or includible under subpart F)