



*U.S. House of Representatives*  
**COMMITTEE ON WAYS AND MEANS**  
*Chairman Kevin Brady*

**Tax Cuts and Jobs Act**  
**H.R. 1**  
**Section-by-Section Summary**

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# **Tax Cuts and Jobs Act**

## **H.R. 1**

### **Section-by-Section Summary**

#### **Section 1. Short title; etc.**

This section provides: (1) a short title for the bill, the “Tax Cuts and Jobs Act”; (2) that when the bill amends or repeals a particular section or other provision, such amendment or repeal generally should be considered as referring to sections or provisions of the Internal Revenue Code of 1986; and (3) a table of contents.

## **Title I – Tax Reform for Individuals**

### **Subtitle A – Reform of Rates, Standard Deduction, and Exemptions**

#### **Sec. 1001. Reduction and simplification of individual income tax rates.**

**Current law:** Under current law, a taxpayer generally determines his regular tax liability by applying the tax rate schedules (or the tax tables) to taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer’s income increases. Separate rate schedules apply based on an individual’s filing status. For tax year 2017, there are seven regular individual income tax brackets of 10 percent, 15 percent, 25 percent, 28 percent, 33 percent, 35 percent, and 39.6 percent. In addition, there are five categories of filing status: single, head of household, married filing jointly (and surviving spouses), married filing separately, and estates and trusts. For married individuals filing jointly, the upper bounds of the 10- and 15-percent brackets are exactly double the upper bounds that apply to single individuals, to prevent a marriage penalty from applying at these income levels. The income levels for each bracket threshold are indexed annually based on increases in the Consumer Price Index (CPI).

**Provision:** Under the provision, the current seven tax brackets would be consolidated and simplified into four brackets: 12 percent, 25 percent, 35 percent, and 39.6 percent, in addition to an effective fifth bracket at zero percent in the form of the enhanced standard deduction. For married taxpayers filing jointly, the 25-percent bracket threshold would be \$90,000, the 35-percent bracket threshold would be \$260,000, and the 39.6-percent bracket threshold would be \$1 million. For unmarried individuals and married individuals filing separately, the bracket thresholds would be half the thresholds for married taxpayers filing jointly, except that the 35-percent bracket threshold for unmarried individuals would be \$200,000. For single parents filing as a head of a household, the bracket thresholds would be the midpoint between the thresholds for unmarried individuals and married taxpayers filing jointly, except that the 39.6-percent bracket threshold for heads of household would be \$500,000. These income levels would be indexed for chained CPI instead of CPI, a slightly different measure of inflation.

For high-income taxpayers, the provision would phase out the tax benefit of the 12-percent bracket, measured as the difference between what the taxpayer pays and what the taxpayer would have paid had the income subject to the 12-percent bracket instead been subject to the 39.6-percent bracket. This tax benefit is phased out at a rate of \$6 of tax savings for every \$100 of adjusted gross income in excess of \$1,00,000 (single filers) or \$1,200,000 (joint filers). These thresholds are adjusted for chained CPI in tax years after 2017.

The provision would be effective for tax years beginning after 2017.

**Considerations:**

- Overall, the changes to the individual rate structure would create a simpler, fairer, and flatter Federal income tax.
- Most economists consider chained CPI to represent a more accurate measure of inflation than CPI.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$961.2 billion over 2018-2027.

**Sec. 1002. Enhancement of standard deduction.**

**Current law:** Under current law, an individual reduces adjusted gross income (AGI) by any personal exemption deductions and either (1) the applicable standard deduction or (2) his itemized deductions to determine taxable income. The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the amount of the standard deduction was \$6,350 for single individuals and married individuals filing separate returns, \$9,350 for heads of households, and \$12,700 for married individuals filing a joint return. The amounts of the basic and additional standard deductions are indexed annually for inflation (CPI). In lieu of taking the applicable standard deductions, an individual may elect to claim itemized deductions.

**Provision:** Under the provision, the standard deduction would be increased to \$24,000 for joint filers (and surviving spouses) and \$12,000 for individual filers. Single filers with at least one qualifying child could claim a standard deduction of \$18,000. These amounts would be adjusted for inflation based on chained CPI. For example, the standard deduction for joint filers would be \$24,400 in 2018.

The provision would be effective for tax years beginning after 2017.

**Considerations:**

- The increase in the standard deduction would achieve substantial simplification by reducing the number of taxpayers who choose to itemize their deductions from roughly one-third under current law to fewer than 10 percent under the legislation.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$921.4 billion over 2018-2027.



### **Sec. 1003. Repeal of deduction for personal exemptions.**

**Current law:** Under current law, a taxpayer generally may claim personal exemptions for the taxpayer, the taxpayer's spouse, and any dependents. For 2017, taxpayers may deduct \$4,050 for each personal exemption. This amount is indexed annually for inflation (CPI). Additionally, the personal exemption phase-out (PEP) reduces a taxpayer's personal exemptions by 2 percent for each \$2,500 (\$1,250 for married filing separately) by which the taxpayer's AGI exceeds \$261,500 (single), \$287,650 (head-of-household), \$313,800 (married filing jointly), and \$150,000 (married filing separately). These threshold amounts apply to tax year 2017 and also are indexed for inflation.

**Provision:** Under the provision, the deduction for personal exemptions and the personal exemption phase-out would be repealed. The provision would be effective for tax years beginning after 2017.

#### **Considerations:**

- The personal exemption for the taxpayer and taxpayer's spouse would be consolidated into a larger standard deduction.
- The personal exemption for children and dependents would be consolidated into an expanded child tax credit and a new family tax credit.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1,562.1 billion over 2018-2027.

### **Sec. 1004. Maximum rate on business income of individuals.**

**Current law:** Under current law, businesses organized as sole proprietorships, partnerships, limited liability companies, and S corporations are generally treated for Federal income tax purposes as "pass-through" entities subject to tax at the individual owner or shareholder level rather than the entity level. Net income earned by owners of these entities is reported on their individual income tax returns and is subject to ordinary income tax rates, up to the top individual marginal rate of 39.6 percent.

Owners or shareholders that provide services to a partnership are not considered employees for Federal income tax purposes. Partnerships may distribute guaranteed payments to service-providing partners, provide a share of partnership profits, or both, as a form of compensation. In contrast, an S corporation shareholder that performs services for the S corporation is treated as an employee for Federal income tax purposes and receives wages in exchange for those services. S corporations are required to provide "reasonable compensation" to employee shareholders, and payments that fail to meet the reasonable compensation standard are subject to recharacterization as wages.

Under current-law Code section 469, certain losses are generally disallowed with respect to passive activities involving the conduct of a trade or business in which the taxpayer does not

materially participate. Under Treasury regulations, special current law rules govern the facts and circumstances used to determine whether a taxpayer materially participates and how an activity is defined.

**Provision:** Under the provision, a portion of net income distributed by a pass-through entity to an owner or shareholder may be treated as “business income” subject to a maximum rate of 25 percent, instead of ordinary individual income tax rates. The remaining portion of net business income would be treated as compensation and continue to be subject to ordinary individual income tax rates.

Each owner or shareholder would separately determine their proportion of business income. Net income derived from a passive business activity would be treated entirely as business income and fully eligible for the 25-percent maximum rate. Owners or shareholders receiving net income derived from an active business activity (including any wages received) would determine their business income by reference to their “capital percentage” of the net income from such activities.

Under the provision, owners or shareholders generally may elect to apply a capital percentage of 30 percent to the net business income derived from active business activities to determine their business income eligible for the 25-percent rate. That determination would leave the remaining 70 percent subject to ordinary individual income tax rates.

Alternatively, owners or shareholders may elect to apply a formula based on the facts-and-circumstances of their business to determine a capital percentage of greater than 30 percent. That formula would measure the capital percentage based on a rate of return (the Federal short-term rate plus 7 percent) multiplied by the capital investments of the business. Once made, the election of the alternative formula would be binding for a five-year period.

A special rule would apply to prevent the recharacterization of actual wages paid as business income. An owner’s or shareholder’s capital percentage would be limited if actual wages or income treated as received in exchange for services from the pass-through entity (*e.g.*, a guaranteed payment) exceeds the taxpayer’s otherwise applicable capital percentage.

The determination of whether a taxpayer is active or passive with respect to a particular business activity would rely on current law material participation and activity rules within regulations governing the limitation on passive activity losses under Code section 469. Under these rules, the determination of whether a taxpayer is active generally is based on the number of hours the taxpayer spends each year participating in the activities of the business.

Income subject to preferential rates, such as net capital gains and qualified dividend income, would be excluded from any determination of a business owner’s capital percentage. Such income would not be recharacterized as business income for these purposes and would retain its character. Certain other investment income that is subject to ordinary rates such as short-term capital gains, dividends, and foreign currency gains and hedges not related to the business needs, would also not be eligible to be recharacterized as business income. Interest income properly allocable to a trade or business would be eligible to be recharacterized as business income.

Under the provision, the default capital percentage for certain personal services businesses (*e.g.*, businesses involving the performance of services in the fields of law, accounting, consulting, engineering, financial services, or performing arts) would be zero percent. As a result, a taxpayer that actively participates in such a business generally would not be eligible for the 25-percent rate on business income with respect to such personal service business. However, the provision would allow the same election to owners of personal services businesses to use an alternative capital percentage based on the business's capital investments. This election would be subject to certain limitations. The provision would also apply a maximum 25-percent rate on certain dividends from a real estate investment trust (REIT) and patronage dividends from cooperatives.

The provision would be effective for tax years beginning after 2017.

**Considerations:**

- Small business owners would receive a rate reduction in addition to the lower individual rates provided in section 1001.
- The provision's distinction between the labor and capital share reflects the fact that over the last several decades, labor's share of national income has remained remarkably constant at approximately 70 percent, which indicates that the capital share has remained constant at 30 percent of national income.<sup>1</sup> The default capital percentage of 30 percent recognizes that a portion of the distributive share of a partnership, LLC, or S corporation represents earnings on invested capital.
- Using the current-law "material participation standard" under the passive activity loss rules is a familiar standard that has been used to enforce the passive loss rules since its enactment in 1986.
- The provision would provide a simple default rule for determining a taxpayer's business income, but would also provide an alternative rule for determining business income for capital-intensive businesses (*e.g.*, manufacturers).

**JCT estimate:** According to JCT, the provision would reduce revenues by \$448.0 billion over 2018-2027.

**Sec. 1005. Conforming amendments related to simplification of individual income tax rates.**

**Current law:** Not applicable.

**Provision:** The provision makes technical and conforming amendments to the Internal Revenue Code related to reduction and simplification of individual income tax rates.

**JCT estimate:** According to JCT, the provision would have no revenue effect over 2018-2027.

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<sup>1</sup> The labor share is derived using Bureau of Economic Analysis data and is calculated as compensation divided by national income less proprietors' income.

## **Subtitle B – Simplification and Reform of Family and Individual Tax Credits**

### **Sec. 1101. Enhancement of child tax credit and new family tax credit.**

**Current law:** Under current law, an individual may claim a tax credit for each qualifying child under the age of 17. The amount of the credit per child is \$1,000. The aggregate amount of child credits that may be claimed is phased out by \$50 for each \$1,000 of AGI over \$75,000 for single filers and \$110,000 for joint filers. Neither the \$1,000 credit amount nor the AGI thresholds are indexed for inflation. The taxpayer must submit a valid taxpayer identification number (TIN) for each child for whom the credit is claimed.

To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit, or ACTC) equal to 15 percent of earned income in excess of \$3,000. The taxpayer is not required to have a Social Security number (SSN) to claim the refundable portion of the credit.

**Provision:** Under the provision, the child credit would be increased to \$1,600. Alternatively, a credit of \$300 would be allowed for non-child dependents.

In addition, a family flexibility credit of \$300 would be allowed with respect to the taxpayer (each spouse in the case of a joint return) who is neither a child nor a non-child dependent. The family flexibility credit and the non-child dependent credit would be effective for taxable years ending before January 1, 2023.

As under current law, the refundable portion of the child tax credit would be limited to \$1,000. That \$1,000 amount would be indexed for inflation based on chained CPI, and over time would rise to match (but not exceed) the \$1,600 base child tax credit. Neither the \$300 credit for non-child dependents nor the \$300 credit for other taxpayers would be refundable.

The phase out for the combined child credit, the non-child dependent credit, and the credit for other taxpayers would be increased from \$110,000 (for joint filers) under current law to \$230,000 (for joint filers), and from \$75,000 (for single filers) to \$115,000 (for single filers). This increase in the phase-out would eliminate the marriage penalty in the credit.

Section 1103 of the legislation would require a taxpayer to provide a Social Security number (SSN) to claim the refundable portion of the credit.

The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$640.0 billion over 2018-2027.

## **Sec. 1102. Repeal of nonrefundable credits.**

**Current law:** Under current law, certain individuals who are over the age of 65 or who have retired on disability before the end of the taxable year may claim a credit for 15 percent of such taxpayer's eligible amount for the year. The eligible amount is \$7,500 for a joint return, \$5,000 for a single individual, or \$3,750 for a married individual filing a joint return. The credit phases out as adjusted gross income exceeds the eligible amount.

Under current law, a taxpayer may claim an adoption tax credit of \$13,570 per eligible child for 2017 (both special needs and non-special needs adoptions). These benefits are phased-out for taxpayers with adjusted gross income (AGI) between \$203,540 and \$243,540 for 2017. The amount of the credit and the income phase-outs are indexed for inflation. For a non-special needs adoption, the credit amount is limited to actual adoption expenses. The credit is not refundable, but unused amounts may be carried forward for five years.

Under current law, some State and local governments issue private activity bonds (PABs) to finance owner-occupied residences. In lieu of issuing such bonds, State and local governments may enable homebuyers to claim a Federal tax credit for interest on certain home mortgages by providing them with mortgage credit certificates.

Under current law, a taxpayer may claim a credit for each qualified plug-in electric-drive motor vehicle placed in service. A qualified plug-in electric-drive motor vehicle is a motor vehicle that has at least four wheels, is manufactured for use on public roads, meets certain emissions standards (except for certain heavy vehicles), draws propulsion using a traction battery with at least four kilowatt hours of capacity, and is capable of being recharged from an external source of electricity. The maximum credit is capped at \$7,500 regardless of vehicle weight. In addition, after that date, no credit is available for low speed plug-in vehicles or for plug-in vehicles weighing 14,000 pounds or more. The total plug-in vehicle limitation is 200,000 plug-in vehicles per manufacturer. The credit phases out over four calendar quarters beginning in the second calendar quarter following the quarter in which the manufacturer limit is reached.

**Provision:** Under the provision, the credit for individuals over age 65 or who have retired on disability, the adoption credit, the tax credit associated with mortgage credit certificates, and the credit for plug-in electric drive motor vehicles would be repealed.

The provision repealing qualified plug-in electric drive motor vehicles would be effective for vehicles placed in service for tax years beginning after 2017. The other provisions would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$4.0 billion over 2018-2027.

### **Sec. 1103. Refundable credit program integrity.**

**Current law:** Under current law, taxpayers must include certain authenticating information on their tax returns when claiming certain credits. For example, in order to claim the child tax credit, a taxpayer must list on a tax return the name and taxpayer identification number of the child for whom the credit is claimed. That taxpayer identification number must have been issued on or before the due date for that tax return. Additionally, in order to claim certain education-related credits, a taxpayer must list on a tax return the name and taxpayer identification number of the student for whom such credit is claimed. Furthermore, in order to claim the earned income tax credit, a taxpayer must list on a tax return his or her Social Security number, as well as the Social Security number of his or her spouse if married. This requirement excludes Social Security numbers that were issued by the Social Security Administration to foreign legal residents solely for the purpose of claiming benefits and not being eligible for employment purposes.

**Provision:** Under the provision, to reduce waste, fraud, and abuse, a taxpayer would be required to provide a work-eligible SSN to claim the refundable portion of the child tax credit or the American Opportunity Tax Credit. The IRS would be granted math error authority to adjust the returns of taxpayers failing to satisfy the identification requirements. In order to claim the refundable Earned Income Tax Credit, a taxpayer would be required to provide a work-eligible social security number.

**JCT estimate:** According to JCT, the provision would increase revenues by \$23.1 billion over 2018-2027.

## **Subtitle C – Simplification and Reform of Education Incentives**

### **Considerations for Subtitle C:**

- Under current law, there are 15 different tax benefits relating to education that often overlap with one another.
- The current law education tax benefits are so complicated that they are ineffective because many taxpayers cannot determine the tax benefits for which they are eligible.
- The IRS publication on tax benefits for education is almost 90 pages long.
- Streamlining education tax benefits would enable taxpayers to better understand the tax benefits for which they qualify.
- The provisions would help to simplify considerably the tax benefits relating to education.

### **Sec. 1201. American opportunity tax credit.**

**Current law:** Under current law, the American Opportunity Tax Credit (AOTC) provides a 100-percent tax credit for the first \$2,000 of certain higher education expenses and a 25-percent tax credit for the next \$2,000 of such expenses, for a maximum credit of \$2,500. The expenses that are eligible for the AOTC include tuition, fees, and course materials. Up to \$1,000 of the AOTC is refundable. The AOTC is available for up to four years of post-secondary education in a degree or certificate program, and generally phases out between modified adjusted gross

income (MAGI) of \$160,000 and \$180,000 for joint filers and \$80,000 and \$90,000 for other filers.

As an alternative to the AOTC, taxpayers may instead claim the Hope Scholarship Credit (HSC) or the Lifetime Learning Credit (LLC). Generally, the HSC is less generous than the AOTC in that it: (1) provides a credit of 100 percent of the first \$1,000 in expenses and 50 percent of the next \$1,000 in expenses; (2) applies only to tuition and fees; (3) is available only for two years of post-secondary education; (4) phases out at MAGI of \$80,000 to \$100,000 (joint filers) and \$40,000 to \$50,000 (other filers); and (5) is not refundable. (Under the HSC, all dollar amounts are indexed for inflation using 2000 as the base year.) The Lifetime Learning Credit (LLC) provides a credit for 20 percent of up to \$10,000 of qualified education expenses for post-secondary education. The LLC is not refundable. There is no limit on the number of years the LLC may be claimed for each student. For 2017, the LLC generally phases out for taxpayers with MAGI between \$56,000 and \$66,000 (\$112,000 and \$132,000 for joint filers). These income phase-outs for the HSC and LLC are adjusted for inflation.

**Provision:** Under the provision, the three existing higher education tax credits described above – AOTC, HSC, LLC – would be consolidated into an enhanced AOTC. The new AOTC, like the current AOTC, would provide a 100-percent tax credit for the first \$2,000 of certain higher education expenses and a 25-percent tax credit for the next \$2,000 of such expenses. Like the current AOTC, expenses covered under the credit include tuition, fees, and course materials. The AOTC would also be available for a fifth year of post-secondary education at half the rate as the first four years, with up to \$500 of such credit being refundable. The HSC and LLC would be repealed. The provision would be effective for tax years beginning after 2017.

**Consideration:** The provision would help to simplify the tax benefits relating to education by consolidating three similar, but not identical, tax benefits – AOTC, HSC, and LLC – into a single, easy-to-understand tax credit.

**JCT estimate:** According to JCT, the provision, would increase revenues by \$17.3 billion over 2018-2027.

## **Sec. 1202. Consolidation of education savings rules.**

**Current law:** Under current law, income earned by Coverdell education savings accounts, which are established for the purpose of paying qualified education expenses of a named beneficiary, is exempt from tax. Contributions are not deductible and may not exceed \$2,000 per beneficiary annually, and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for contributors with modified adjusted gross income between \$95,000 and \$110,000 (\$190,000 and \$220,000 for married taxpayers filing a joint return). Distributions from a Coverdell account are excludable from the gross income of the beneficiary if used to pay for qualified education expenses. Qualified education expenses include qualified higher education expenses and qualified elementary and secondary school expenses for attendance in kindergarten through grade 12.

**Provision:** Under the provision, new contributions to Coverdell education savings accounts after 2017 (except rollover contributions) would be prohibited, but tax-free rollovers from Coverdell accounts into section 529 plans would be allowed. Elementary and high school expenses of up to \$10,000 per year would be qualified expenses for section 529 plans. Qualified expenses would also be expanded to cover expenses associated with apprenticeship programs.

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.

The provision would be effective for contributions and distributions made after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.6 billion over 2018-2027.

### **Sec. 1203. Reforms to discharge of certain student loan indebtedness.**

**Current law:** Under current law, any debt that is forgiven constitutes income. That includes student loans, even if such loans are forgiven on account of death or disability.

**Provision:** Under the provision, any income resulting from the discharge of student debt on account of death or total disability of the student would be excluded from taxable income. The provision would exclude from income repayment of a taxpayer's loans pursuant to the Indian Health Service Loan Repayment Program. The provision would be effective for discharges of indebtedness received after 2017 and amounts received in taxable years beginning after 2017.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$0.1 billion over 2018-2027.

### **Sec. 1204. Repeal of other provisions relating to education.**

**Current law:**

#### *Interest Payments on Qualified Education Loans*

Under current law, an individual may claim an above-the-line deduction for interest payments on qualified education loans for qualified higher education expenses of the taxpayer, the taxpayer's spouse, or dependents. The maximum amount of the deduction is \$2,500. Only taxpayers with modified adjusted gross income (MAGI) below certain inflation-adjusted amounts qualify for the exclusion. For 2017, the exclusion phases out between \$135,000 and \$165,000 for joint returns and between \$65,000 and \$80,000 for other returns. These income phase outs are indexed for inflation.



### *Tuition and Related Expenses*

Prior to 2017, an individual also could claim an above-the-line deduction for qualified tuition and related expenses incurred. A taxpayer was ineligible for the deduction if one of the above credits is claimed. The maximum amount of the deduction was \$4,000 for taxpayers whose adjusted gross income (AGI) did not exceed \$65,000 (\$130,000 in the case of a joint return), and \$2,000 for taxpayers whose AGI did not exceed \$80,000 (\$160,000 in the case of a joint return).

### *Interest on United States Savings Bonds*

Under current law, interest on United States savings bonds is excluded from income if used to pay qualified higher education expenses. Only taxpayers with MAGI below certain (inflation-adjusted) levels qualify for the exclusion. For 2017, the exclusion phases out between \$117,250 and \$147,250 for joint returns and between \$78,150 and \$93,150 for other returns. These income phase outs are indexed for inflation.

### *Qualified Tuition Reductions*

Under current law, qualified tuition reductions provided by educational institutions to their employees, spouses, or dependents are excluded from income. The exclusion may be provided in the form of either reduced tuition or cash. The reduction must be part of a program that does not discriminate in favor of highly compensated employees and may not apply to graduate programs (except for a graduate student who is teaching or a research assistant).

### *Employer-Provided Education Assistance*

Under current law, employer-provided education assistance is excluded from income. The exclusion is limited to \$5,250 per year and applies to both graduate and undergraduate courses. The education assistance must be part of a written plan of the employer that does not discriminate in favor of highly compensated employees.

### **Provision:**

Under the provision, the deduction for interest on education loans and the deduction for qualified tuition and related expenses would be repealed. The exclusion for interest on United States savings bonds used to pay qualified higher education expenses, the exclusion for qualified tuition reduction programs, and the exclusion for employer-provided education assistance programs would also be repealed.

The exclusion for education assistance programs would be effective for amounts paid or incurred after 2017. The other provisions would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$47.5 billion over 2018-2027.

## **Subtitle D – Simplification and Reform of Deductions**

Note: The JCT revenue estimate for the bill reports only the combined, aggregate revenue effect of a number of separate provisions making changes to certain itemized deductions. The specific provisions for which JCT reports aggregate revenue effect are as follows:

- Repeal of overall limitation on itemized deductions
- Mortgage interest
- Repeal of deduction for taxes not paid or accrued in a trade or business
- Repeal of deduction for personal casualty losses
- Repeal of deduction for state and local income taxes and sales taxes
- Allow a deduction only for personal casualty losses for those affected by Hurricanes
- Charitable contributions
- Repeal of deduction for tax preparation expenses
- Repeal of deduction for medical expenses
- Denial of deduction for expenses attributable to the trade or business of being an employee

According to JCT, these provisions, taken together, would increase revenues by \$1,261.3 billion over 2018-2027.

### **Sec. 1301. Repeal of overall limitation on itemized deductions.**

**Current law:** Under current law, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is limited for certain upper-income taxpayers (sometimes referred to as the “Pease limitation”). This limitation applies on top of any other limitations applicable to such deductions. Under the Pease limitation, the otherwise allowable total amount of itemized deductions is reduced by 3 percent of the amount by which the taxpayer’s adjusted gross income exceeds a threshold amount. For 2017, the threshold amount is (1) \$261,500 for single individuals, (2) \$313,800 for married couples filing joint returns and surviving spouses, (3) \$287,650 for heads of households, and (4) \$156,900 for married individuals filing a separate return. The Pease limitation does not reduce itemized deductions by more than 80 percent.

**Provision:** Under the provision, the overall limitation on itemized deductions would be repealed. The provision would be effective for tax years after 2017.

**JCT estimate:** For information about JCT’s revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

### **Sec. 1302. Mortgage interest**

**Current law:** Under current law, a taxpayer may claim an itemized deduction for mortgage interest paid with respect to a principal residence and one other residence of the taxpayer. Itemizers may deduct interest payments on up to \$1 million in acquisition indebtedness (for

acquiring, constructing, or substantially improving a residence), and up to \$100,000 in home equity indebtedness. Under the alternative minimum tax (AMT), however, the deduction for home equity indebtedness is disallowed.

**Provision:** Under the provision, a taxpayer may continue to claim an itemized deduction for interest on acquisition indebtedness. For debt incurred after the effective date of November 2, 2017, the \$1 million limitation would be reduced to \$500,000. Interest would be deductible only on a taxpayer's principal residence. Similar to the current-law AMT rule, interest on home equity indebtedness incurred after the effective date would not be deductible. In the case of refinancings of debt incurred prior to November 2, 2017, the refinanced debt generally would be treated as incurred on the same date that the original debt was incurred for purposes of determining the limitation amount applicable to the refinanced debt. In the case of a taxpayer who enters into a written binding contract before November 2, 2017, the related debt would be treated as being incurred prior to November 2, 2017.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

### **Sec. 1303. Repeal of deduction for certain taxes not paid or accrued in a trade or business.**

**Current law:** Under current law, an individual may claim an itemized deduction for State and local government income and property taxes paid. In lieu of the itemized deduction for State and local income taxes, individuals may claim an itemized deduction for State and local government sales taxes.

**Provision:** Under the provision, individuals would not be allowed an itemized deduction for State and local income or sales taxes, but would continue to be entitled to a deduction for State and local income or sales taxes paid or accrued in carrying on a trade or business or producing income.

Individuals would continue to be allowed to claim an itemized deduction for real property taxes paid up to \$10,000.

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

#### **Considerations:**

- In conjunction with an increased standard deduction and lower overall tax rates, the provision would simplify the tax laws for taxpayers who currently claim itemized deductions for non-business State and local taxes.
- The provision would eliminate a tax benefit that effectively subsidizes higher State and local taxes and increased spending at the State and local level.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

#### **Sec. 1304. Repeal of deduction for personal casualty losses.**

**Current law:** Under current law, an individual may claim an itemized deduction for personal casualty losses (*i.e.*, losses not connected with a trade or business or entered into for profit), including property losses arising from fire, storm, shipwreck, or other casualty, or from theft.

Certain off-code tax legislation enacted in the past, including the Disaster Tax Relief and Airport and Airway Extension Act of 2017, has provided for a special above-the-line deduction for personal casualty losses arising from specified natural disasters.

**Provision:** Under the provision, the deduction for personal casualty losses would generally be repealed. The provision would be effective for tax years beginning after 2017. The deduction for personal casualty losses associated with special disaster relief legislation would not be affected.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

#### **Sec. 1305. Limitation on wagering losses.**

**Current law:** Under current law, a taxpayer may claim an itemized deduction for losses from gambling, but only to the extent of gambling winnings. However, taxpayers may claim other deductions connected to gambling that are deductible regardless of gambling winnings.

**Provision:** Under the provision, all deductions for expenses incurred in carrying out wagering transactions (not just gambling losses) would be limited to the extent of wagering winnings. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.1 billion over 2018-2027.

#### **Sec. 1306. Charitable contributions.**

**Current law:** Under current law, a taxpayer may claim an itemized deduction for charitable contributions. To be eligible, a contribution must be made by the last day of the tax year for which a return is filed. Thus, for a calendar year taxpayer, a contribution must be made on or before December 31 to be included on a tax return for that tax year, which must be filed by April 15 of the following year.

A charitable contribution deduction is limited to a certain percentage of the individual's adjusted gross income (AGI). The AGI limitation varies depending on the type of property contributed and the type of exempt organization receiving the property. In general, cash contributed to public charities, private operating foundations, and certain non-operating private foundations

may be deducted up to 50 percent of the donor's AGI. Contributions that do not qualify for the 50-percent limitation (e.g., contributions to private foundations) may be deducted up to the lesser of (1) 30 percent of AGI, or (2) the excess of the 50-percent-of-AGI limitation for the tax year over the amount of charitable contributions subject to the 30-percent limitation.

Capital gain (i.e., appreciated) property contributed to public charities, private operating foundations, and certain non-operating private foundations may be deducted up to 30 percent of AGI. Capital gain property contributed to non-operating private foundations may be deducted up to the lesser of (1) 20 percent of AGI, or (2) the excess of the 30-percent-of-AGI limitation over the amount of property subject to the 30-percent limitation for contributions of capital gain property.

If an individual contributes more than the applicable AGI limits, the excess contribution generally may be carried over and deducted in the following five tax years, or 15 years in the case of qualified conservation contributions.

In general, a charitable deduction is disallowed to the extent a taxpayer receives a benefit in return. A special rule, however, permits taxpayers to deduct as a charitable contribution 80 percent of the value of a contribution made to an educational institution to secure the right to purchase tickets for seating at an athletic event in a stadium at that institution. When computing the deduction for a charitable contribution in the form of use of a passenger vehicle, a taxpayer is generally allowed to claim a standard rate of 14 cents per mile.

In certain cases, the charitable contribution deduction is subject to special rules. In general, a deduction is allowed for a contribution of \$250 or more only if the taxpayer provides a contemporaneous written acknowledgement by the organization to which the contribution is made, meeting certain informational requirements. However, this requirement is waived if the donee organization files a return including the information otherwise required.

**Provision:** Under the provision, several changes would be made to the rules applicable to charitable contributions, all of which, unless otherwise indicated, would be effective for tax years beginning after 2017.

#### *AGI limitations for Cash Contributions*

Under the provision, the 50-percent limitation for cash contributions to public charities and certain private foundations would be 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.

#### *College Athletic Event Seating Rights*

Under the provision, the special rule that provides a charitable deduction of 80 percent of the amount paid for the right to purchase tickets for athletic events would be repealed.

#### *Charitable Mileage Rate Adjusted for Inflation*

Under the provision, the amount deductible per mile driven in service to a charitable organization would be adjustable for inflation.

*Repeal of Substantiation Exception in Case of Contributions Reported by Donee*

Under the provision, the exception that relieves a taxpayer from providing a contemporaneous written acknowledgment by the donee organization for contributions of \$250 or more when the donee organization files a return with the required information would be repealed.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

**Sec. 1307. Repeal of deduction for tax preparation expenses.**

**Current law:** Under current law, an individual may claim an itemized deduction for tax preparation expenses.

**Provision:** Under the provision, an individual would not be allowed an itemized deduction for tax preparation expenses. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

**Sec. 1308. Repeal of medical expense deduction.**

**Current law:** Under current law, a taxpayer may claim an itemized deduction for out-of-pocket medical expenses of the taxpayer, a spouse, or a dependent. This deduction is allowed only to the extent the expenses exceed ten percent of the taxpayer's adjusted gross income.

**Provision:** Under the provision, the itemized deduction for medical expenses would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.

**Sec. 1309. Repeal of deduction for alimony payments.**

**Current law:** Under current law, alimony payments generally are an above-the-line deduction for the payor and included in the income of the payee. However, alimony payments are not deductible by the payor or includible in the income of the payee if designated as such by the divorce decree or separation agreement.

**Provision:** Under the provision, alimony payments would not be deductible by the payor or includible in the income of the payee. The provision would be effective for any divorce decree or separation agreement executed after 2017 and to any modification after 2017 of any such instrument executed before such date if expressly provided for by such modification.

**Considerations:**

- The provision would eliminate what is effectively a “divorce subsidy” under current law, in that a divorced couple can often achieve a better tax result for payments between them than a married couple can.
- The provision recognizes that the provision of spousal support as a consequence of a divorce or separation should have the same tax treatment as the provision of spousal support within the context of a married couple, as well as the provision of child support.

**JCT estimate:** According to JCT, the provision would increase revenues by \$8.3 billion over 2018-2027.

**Sec. 1310. Repeal of deduction for moving expenses.**

**Current law:** Under current law, a taxpayer may claim a deduction for moving expenses incurred in connection with starting a new job, regardless of whether or not the taxpayer itemizes his deductions. To qualify, the new workplace generally must be at least 50 miles farther from the former residence than the former place of work or, if the taxpayer had no former workplace, at least 50 miles from the former residence.

**Provision:** Under the provision, the deduction for moving expenses would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$10.6 billion over 2018-2027.

**Sec. 1311. Termination of deduction and exclusions for contributions to medical savings accounts.**

**Current law:** Under current law, an individual may claim an above-the-line deduction for contributions to an Archer Medical Savings Account (MSA) and exclude from income employer contributions to an MSA. In general, Archer MSAs may be set up by an individual working for a small employer and who participates in the employer’s high-deductible health plan. The total amount of monthly contributions to an Archer MSA may not exceed one-twelfth of 65 percent of the annual deductible for an individual with a self-only plan and one-twelfth of 75 percent of the annual deductible for an individual with family coverage. Distributions from the accounts used to pay qualified medical expenses are not taxable. Archer MSAs may not be established after 2005. Archer MSA balances may be rolled over on a tax-free basis to another Archer MSA or to a Health Savings Account (HSA).

**Provision:** Under the provision, no deduction would be allowed for contributions to an Archer MSA, and employer contributions to an Archer MSA would not be excluded from income. Existing Archer MSA balances, however, could continue to be rolled over on a tax-free basis to an HSA. The provision would be effective for tax years beginning after 2017.

**Considerations:**

- There is no manner in which Archer MSAs are more favorable than HSAs; thus, no taxpayer would see his ability to save for future health costs restricted.
- As a result, the provision merely simplifies the Code by consolidating two similar tax-favored accounts into a single account with more taxpayer-friendly rules (*i.e.*, HSAs).

**JCT estimate:** According to JCT, the provision would have negligible revenue effect over 2018-2027.

**Sec. 1312. Denial of deduction for expenses attributable to the trade or business of being an employee.**

**Current law:** Under current law, a taxpayer generally may claim a deduction for trade and business expenses, regardless of whether the taxpayer itemizes deductions or takes the standard deduction. Taxpayers generally may claim expenses relating to the trade or business of being an employee only if they itemize deductions. Certain expenses attributable to the trade or business of being an employee, however, are allowed as above-the-line deductions, including reimbursed expenses included in the employee's income, certain expenses of performing artists, certain expenses of State and local government officials, certain expenses of elementary and secondary school teachers, and certain expenses of members of reserve components of the United States military.

**Provision:** Under the provision, a taxpayer would not be allowed an itemized deduction for expenses attributable to the trade or business of performing services as an employee. In addition, the only above-the-line deductions allowed for expenses attributable to the trade or business of being an employee would be those for reimbursed expenses and certain expenses of members of reserve components of the United States military. The provision would be effective for tax years beginning after 2017.

**Considerations:**

- In conjunction with an increased standard deduction and lower overall tax rates, the provision would simplify the tax laws for taxpayers who currently claim deductions for employee business expenses.
- Keeping records of these expenses is often very burdensome for taxpayers, and this current-law deduction also poses administrative and enforcement challenges for the IRS.

**JCT estimate:** For information about JCT's revenue estimate for this provision, see the note immediately following the heading for Subtitle D of Title I in this document.



## **Subtitle E – Simplification and Reform of Exclusions and Taxable Compensation**

### **Sec. 1401. Limitation on exclusion for employer-provided housing.**

**Current law:** Under current law, housing and meals provided to an employee and the employee’s spouse or dependents for the convenience of the employer are excluded from income if the meals are on the business premises of the employer and the employee is required to accept lodging on the premises of the employer as a condition of employment. In the case of educational institutions, the value of housing provided to their employees also is excluded to the extent the rent paid by the employee is at least the lesser of five percent of the lodging’s appraised value or the average of the rent paid by individuals (other than employees or students of the educational institution) for comparable lodging provided by the educational institution.

**Provision:** Under the provision, the exclusion for housing provided for the convenience of the employer and for employees of educational institutions would be limited to \$50,000 (\$25,000 for a married individual filing a joint return) and would phase out for highly compensated individuals (income of \$120,000 for 2017, as adjusted for inflation) at a rate of one dollar for every two dollars of adjusted gross income earned by the individual beyond the statutory threshold of being highly compensated. The exclusion also would be limited to one residence. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by less than \$50 million over 2018-2027.

### **Sec. 1402. Exclusion of gain from sale of a principal residence.**

**Current law:** Under current law, a taxpayer may exclude from gross income up to \$500,000 for joint filers (\$250,000 for other filers) of gain on the sale of a principal residence. The property generally must have been owned and used as the taxpayer’s principal residence for two out of the previous five years. A taxpayer may use this exclusion only once every two years.

**Provision:** Under the provision, a taxpayer would have to own and use a home as the taxpayer’s principal residence for five out of the previous eight years to qualify for the exclusion. In addition, the taxpayer would be able to use the exclusion only once every five years. The exclusion would be phased out by one dollar for every dollar by which a taxpayer’s adjusted gross income exceeds \$500,000 (\$250,000 for single filers). The provision would be effective for sales and exchanges after 2017.

#### **Considerations:**

- The provision would continue to protect homeowners who either do not have the documentation to establish basis in their home or who have experienced gains as a result of inflation over a long period of ownership. Meanwhile, speculators and so-called “flippers” in the housing market would not be rewarded for their activity with tax-exempt income.

- The provision’s “five-out-of-eight year” rule existed prior to 1978, when Congress decided to reduce the necessary holding period. This provision would merely restore the holding period requirement to what it was prior to 1978.

**JCT estimate:** According to JCT, the provision would increase revenues by \$22.4 billion over 2018-2027.

### **Sec. 1403. Repeal of exclusion, etc., for employee achievement awards.**

**Current law:** Under current law, employee achievement awards are excluded from employees’ income. To qualify for the tax exclusion, an employee achievement award must be given in recognition of the employee’s length of service or safety achievement at a ceremony that is a meaningful presentation. Furthermore, the conditions and circumstances cannot suggest a significant likelihood that the payment is disguised compensation. The employee is taxed to the extent that the cost (or value, if greater) of the award exceeds the employer’s deduction for the award. The employer’s deduction for employee achievement awards for any employee in any year cannot exceed \$1,600 for qualified plan awards, and \$400 otherwise. A qualified plan award is an employee achievement award that is part of an established written program of the employer, which does not discriminate in favor of highly compensated employees. In addition, the average award (not counting those of nominal value) may not exceed \$400.

**Provision:** The provision would repeal the exclusion for employee achievement awards, so that such awards would constitute taxable compensation to the recipient. The provision also would repeal the restrictions on employer deductions for such awards. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$3.8 billion over 2018-2027.

### **Sec. 1404. Repeal of exclusion for dependent care assistance programs.**

**Current law:** Under current law, the value of employer-provided dependent care assistance programs are excluded from employees’ income up to a limit of \$5,000 per year (\$2,500 for married filing separately) to help pay for work-related expenses of caring for a child under the age of 13 or spouses or other dependents who are physically or mentally unable to care for themselves. Work-related expenses are those that help an individual work or look for work. Dependent care assistance programs must be part of a written plan of the employer that does not discriminate in favor of highly compensated employees.

**Provision:** The provision would repeal the exclusion for dependent care assistance programs. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$3.0 billion over 2018-2027.

### **Sec. 1405. Repeal of exclusion for qualified moving expense reimbursement.**

**Current law:** Under current law, qualified moving expense reimbursements provided by an employer to an employee are excluded from the employee's income. Qualified moving expenses are payments received by an individual from an employer as a payment for or reimbursement of expenses by an employee that would be deductible as moving expenses under section 217 if directly paid or incurred by the individual.

**Provision:** The provision would repeal the exclusion for qualified moving expense reimbursements. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$7.7 billion over 2018-2027.

### **Sec. 1406. Repeal of exclusion for adoption assistance programs.**

**Current law:** Under current law, adoption assistance programs that make payments of qualified adoption expenses from an employer to an employee are excluded from the employee's income. Qualified adoption expenses are amounts paid or expenses incurred for the adoption of a child. Qualified adoption expenses are limited to an amount indexed for inflation, which is \$13,570 for 2017. An individual who adopts a special-needs child can receive the \$13,570 limit amount regardless of actual costs associated with the adoption of that child. Adoption assistance programs must be part of a written plan of the employer.

**Provision:** The provision would repeal the exclusion for adoption assistance programs. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by less than \$50 million over 2018-2027.

## **Subtitle F – Simplification and Reform of Savings, Pensions, Retirement**

### **Sec. 1501. Repeal of special rule permitting recharacterization of Roth IRA contributions as traditional IRA contributions.**

**Current law:** Under current law, an individual may re-characterize a contribution to a traditional IRA as a contribution to a Roth IRA (and vice versa). An individual may also re-characterize a conversion of a traditional IRA to a Roth IRA. The deadline for re-characterization generally is October 15 of the year following the conversion. When a re-characterization occurs, the individual is treated for tax purposes as not having made the conversion. The recharacterization must include any net earnings related to the conversion.

**Provision:** Under the provision, the rule allowing recharacterization of IRA contributions and conversions would be repealed. The provision would be effective for tax years beginning after 2017.

**Consideration:** This provision would prevent a taxpayer from gaming the system by, for example, contributing or converting to a Roth IRA, investing aggressively and benefiting from any gains (which are never subject to tax), and then retroactively reversing the conversion if the taxpayer suffers a loss so as to avoid taxes on some or all of the converted amount.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.5 billion over 2018-2027.

### **Sec. 1502. Reduction in minimum age for allowable in-service distributions.**

**Current law:** Under current law, defined contribution plans generally are not permitted to allow in-service distributions (*i.e.*, distributions while an employee is still working for the employer) attributable to tax-deferred contributions if the employee is less than 59½ years old. For State and local government defined contribution plans, and for all defined benefit plans, the restriction on in-service distributions applies if the employee is less than age 62.

**Provision:** Under the provision, all defined benefit plans as well as State and local government defined contribution plans would be permitted to make in-service distributions beginning at age 59½. The provision would be effective for plan years beginning after 2017.

#### **Considerations:**

- The provision would encourage Americans to continue working full or part-time instead of retiring early in order to access retirement savings at age 59½. Under current law, many employees choose to retire instead of continuing to work because they cannot otherwise access their retirement accounts.
- The provision would provide uniformity across various plan types, allowing all plans to offer in-service distributions at age 59½ instead of having different ages for different types of plans. The varying rules under current law have no apparent justification.

**JCT estimate:** According to JCT, the provision would increase revenues by \$13.1 billion over 2018-2027.

### **Sec. 1503. Modification of rules governing hardship distributions.**

**Current law:** Under current law, defined contribution plans are generally not permitted to allow in-service distributions (distributions while an employee is still working for the employer) attributable to elective deferrals if the employee is less than 59½ years old. One exception is for hardship distributions, which plans may offer participants only if the plan follows guidelines such as requiring an immediate and heavy financial need of the employee for any distribution to

be made. Treasury regulations require that plans not allow employees taking hardship distributions to make contributions to the plan for six months after the distribution.

**Provision:** Under the provision, the IRS would be required within one year of the date of enactment to change its guidance to allow employees taking hardship distributions to continue making contributions to the plan. The revised regulations under this provision would be effective for plan years beginning after 2017.

**Considerations:**

- The provision would help Americans save for retirement by making common-sense reforms to remove harsh rules that often trap individuals and families going through difficult financial circumstances.
- The provision would overturn Treasury regulations requiring individuals to stop making contributions to their retirement plans in order to take hardship distributions, which often results in such individuals failing to resume saving for retirement in the future.

**JCT estimate:** According to JCT, the provision would have negligible revenue effect over 2018-2027.

**Sec. 1504. Modification of rules relating to hardship withdrawals from cash or deferred arrangements.**

**Current law:** Under current law, defined contribution plans are generally not permitted to allow in-service distributions (distributions while an employee is still working for the employer) attributable to elective deferrals if the employee is less than 59½ years old. One exception is for hardship distributions, which plans have the option of offering to participants. Hardship distributions may be allowed only for amounts actually contributed by the employee and may not include account earnings or amounts contributed by the employer.

**Provision:** Under the provision, employers may choose to allow hardship distributions to also include account earnings and employer contributions. The provision would be effective for plan years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.7 billion over 2018-2027.

**Sec. 1505. Extended rollover period for the rollover of plan loan offset amounts in certain cases.**

**Current law:** Under current law, defined contribution plans are permitted (but not required) to allow plan loans. If the employee fails to abide by the applicable rules, the loan is treated as a taxable distribution that may also be subject to the 10-percent penalty for early withdrawals. If a plan terminates or an employee's employment terminates while a plan loan is outstanding, the

employee has 60 days to contribute the loan balance to an individual retirement account (IRA), or the loan is treated as a distribution.

**Provision:** Under the provision, employees whose plan terminates or who separate from employment while they have plan loans outstanding would have until the due date for filing their tax return for that year to contribute the loan balance to an IRA in order to avoid the loan being taxed as a distribution. The provision would apply to tax years beginning after 2017.

**Considerations:**

- The provision would help Americans save for retirement by making common-sense reforms to remove harsh rules that often trap individuals and families going through difficult financial circumstances.
- The provision would overturn the current rule requiring individuals who lose their jobs to roll over any outstanding retirement plan loans to an IRA within 60 days or be subject to taxes and penalties on the loan amount.

**JCT estimate:** According to JCT, the provision would have negligible revenue effect over 2018-2027.

**Sec. 1506. Modification of nondiscrimination rules to protect older, longer service participants.**

**Current law:** Under current law, employer-sponsored retirement plans must meet a variety of requirements in order to be tax-qualified, including nondiscrimination rules designed to ensure that the group of employees covered by a plan and the contribution or benefits provided to employees must not discriminate in favor of highly compensated employees. In general, employers may choose to stop allowing employees to accrue new benefits in a plan or only allow existing employees to accrue new benefits while closing the plan to new employees. For employers sponsoring both a defined contribution plan and a defined benefit plan, the nondiscrimination rules allow limited cross-testing between the two plans. However, some employers who allow current workers to continue to accrue benefits but have closed their defined benefit plan to new employees come to violate the nondiscrimination rules.

**Provision:** Under the provision, expanded cross-testing between an employer's defined benefit and defined contributions would be allowed for purposes of the nondiscrimination rules. The provision would generally take effect on the date of enactment.

**JCT estimate:** According to JCT, the provision would have negligible revenue effect over 2018-2027.

## Subtitle G – Estate and Generation-skipping Transfer Taxes

### **Sec. 1601-1602. Increase in credit against estate, gift, and generation-skipping transfer tax; Repeal of estate and generation-skipping transfer taxes.**

**Current law:** Under current law, property in an estate is generally subject to a top tax rate of 40 percent before it passes to the estate’s beneficiaries. When property is transferred during the life of a donor, it is subject to a top gift tax rate of 40 percent, with the first \$14,000 being excluded from the gift tax on a per-donee, annual basis. Additionally, property that is transferred beyond one generation, whether by bequest or by gift, is subject to an additional generation-skipping tax, also with a top tax rate of 40 percent. The first \$5 million worth of transferred property is exempt from the estate, gift, and generation-skipping taxes, in any combination thereof. This amount is known as the basic exclusion amount and is indexed for inflation (\$5.49 million for 2017). Transfers between spouses are excluded from these taxes, and when an individual dies without his or her assets exhausting the basic exclusion amount, any unused basic exclusion amount passes to his or her surviving spouse, with a top basic exclusion amount of \$10.98 million for 2017. When a beneficiary receives property from an estate, the beneficiary generally takes a basis in that property equal to its fair-market value at the time the decedent dies, which is known as taking a step-up in basis. However, when a donee receives a gift from a living donor, that donee generally takes the donor’s basis in that property, which is known as taking a carryover basis.

**Provision:** Under the provision, the basic exclusion amount is doubled from \$5 million (as of 2011) to \$10 million, which is indexed for inflation. This provision would apply to tax years beginning after 2017. Furthermore, beginning after 2023, the estate and generation-skipping taxes are repealed while maintaining a beneficiary’s stepped-up basis in estate property. The gift tax is lowered to a top rate of 35 percent and retains a basic exclusion amount of \$10 million and an annual exclusion of \$14,000 (as of 2017), also indexed for inflation.

#### **Considerations:**

- The estate and generation-skipping taxes impose additional levels on tax on income and assets that have generally already been subject tax. By repealing the estate and generation-skipping taxes, family businesses that would pass from one generation to the next would no longer be subject to double or even triple taxation.
- By repealing the estate and generation-skipping taxes, a small business would no longer be penalized for growing to the point of being taxed upon the death of its owner, thus incentivizing the owner to continue to invest in more capital and hire more employees.

**JCT estimate:** According to JCT, the provisions of section 1601 and 1602 would reduce revenues by \$172.2 billion over 2018-2027.

## **Title II – Alternative Minimum Tax Repeal**

### **Sec. 2001. Repeal of alternative minimum tax.**

**Current law:** Under current law, taxpayers must 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 their regular income tax liability or AMT liability. In computing the AMT, only alternative minimum taxable income (AMTI) above an AMT exemption amount is taken into account, but AMTI represents a broader base of income than regular taxable income. For example, personal exemptions, the standard deduction, and certain itemized deductions (such as the deduction for State and local taxes) are not allowed in calculating AMTI. In addition, many business tax preferences that are allowed for regular taxable income are not allowed in determining AMTI, including accelerated depreciation. Corporations and, in some cases, non-corporate taxpayers receive a credit for AMT paid, which they may carry forward and claim against regular tax liability in future tax years (to the extent such liability exceeds AMT in a particular year), and which never expire.

For individuals, estates, and trusts, the AMT has a 26-percent bracket and a 28-percent bracket, but capital gains and dividends are taxed under the AMT at the highest rate that such items are taxed under the regular income tax. The 26-percent tax rate applies to the first \$182,500 of AMTI (half that amount for married couples filing separately), and the 28-percent rate applies to AMTI in excess of that amount. For 2017, the AMT exemption amounts for non-corporate taxpayers are \$54,300 for single filers, \$84,500 for joint filers, \$42,250 for married individuals filing separately, and \$24,100 for estates and trusts. The AMT exemption amounts begin phasing out at a 25-percent rate at \$160,900 for joint returns, \$120,700 for singles, and \$80,450 for married individuals filing separately and trusts and estates. These amounts are indexed for inflation.

The corporate AMT rate is 20 percent, and the exemption amount is \$40,000, though 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 for corporations phases out at a 25-percent rate starting at \$150,000.

**Provision:** Under the provision, the AMT would be repealed. If a taxpayer has AMT credit carryforwards, the taxpayer would be able to claim a refund of 50 percent of the remaining credits (to the extent the credits exceed regular tax for the year) 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. The provision would generally be effective for tax years beginning after 2017.

#### **Considerations:**

- The requirement that taxpayers compute their income for purposes of both the regular income tax and the AMT is one of the most far-reaching complexities of the current Code.
- According to JCT, the AMT affected about 4.5 million American families in 2017.



- The AMT is particularly burdensome for small businesses, which often do not know whether they will be affected until they file their taxes and therefore must maintain a reserve that cannot be used to hire, expand, and give raises to workers.
- In its 2001 tax simplification report, JCT concluded that the AMT “no longer serves the purposes for which it was intended,” and recommended its repeal.

**JCT estimate:** According to JCT, the repeal of the individual AMT would reduce revenues by \$695.5 billion over 2018-2027, and the repeal of the corporate AMT would reduce revenues by \$40.3 billion over 2018-2027.

## Title III – Business Tax Reform

### Subtitle A – Tax Rates

#### Sec. 3001. Reduction in corporate tax rate.

**Current law:** Under current law, a corporation’s regular income tax liability generally is determined by applying the following tax rate schedule to its taxable income:

<u>Taxable income:</u>	<u>Tax rate:</u>
\$0-\$50,000	15 percent
\$50,001-\$75,000	25 percent
\$75,001-\$10,000,000	34 percent
Over \$10,000,000	35 percent

The 15- and 25-percent rates are phased out for corporations with taxable income between \$100,000 and \$335,000. As a result, a corporation with taxable income between \$335,000 and \$10,000,000 effectively is subject to a flat tax rate of 34 percent. Similarly, the 34-percent rate is gradually phased out for corporations with taxable income between \$15,000,000 and \$18,333,333, such that a corporation with taxable income of \$18,333,333 or more effectively is subject to a flat rate of 35 percent.

Personal service corporations are not entitled to use the graduated corporate rates below the 35-percent rate. A personal service corporation is a corporation the principal activity of which is the performance of personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and such services are substantially performed by the employee-owners.

**Provision:** Under the provision, the corporate tax rate would be a flat 20-percent rate beginning in 2018. Personal services corporations would be subject to a flat 25-percent corporate tax rate. The provision would be effective for tax years beginning after 2017.

#### **Considerations:**

- Today, U.S. corporations are subject to the highest combined Federal and State tax rate in the industrialized world, which puts American multinational companies at a significant competitive disadvantage against their global competitors.
- Lowering the corporate rate from 35 percent to 20 percent not only would increase America’s ability to compete internationally, but also would ensure that American corporations have more resources here in the United States to invest, hire, and grow their businesses.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$1,461.5 billion over 2018-2027.

## Subtitle B – Cost Recovery

### **Sec. 3101. Increased expensing.**

**Current law:** Under current law, taxpayers may take additional depreciation in the year in which it places certain “qualified property” in service through 2019 (with an additional year for certain qualified property with a longer production period). The amount of this additional depreciation is 50 percent of the cost of such property placed in service during 2017 and phases down to 40 percent in 2018 and 30 percent in 2019. Qualified property that is eligible for this additional depreciation is tangible personal property with a recovery period of 20 years or less under the modified accelerated cost recovery system (MACRS), certain off-the-shelf computer software, water utility property, and qualified improvement property. Certain trees, vines, and plants bearing fruit or nuts are also eligible for this additional depreciation when planted or grafted, rather than when placed in service. Finally, to be eligible for this additional depreciation, the original use of the property must begin with the taxpayer.

Current law allows taxpayers to elect to accelerate the use of their AMT credits in lieu of this additional depreciation.

**Provision:** Under the provision, taxpayers would be able to fully and immediately expense 100 percent of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023 (with an additional year for certain qualified property with a longer production period). The provision would expand the property that is eligible for this immediate expensing by repealing the requirement that the original use of the property begin with the taxpayer. Instead, the property would be eligible for the additional depreciation if it is the taxpayer’s first use. Under the provision, qualified property would not include any property used by a regulated public utility company or any property used in a real property trade or business.

Under the provision, the taxpayer’s election to use AMT in lieu of the additional depreciation would be repealed. The repeal of this election would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$25.0 billion over 2018-2027.

## Subtitle C – Small Business Reforms

### **Sec. 3201. Expansion of section 179 expensing.**

**Current law:** Under current law, businesses may immediately expense up to \$500,000 of the cost of any “section 179 property” placed in service each taxable year. If the business places in service more than \$2 million of section 179 property in a taxable year, then the amount available for immediate expensing is reduced by the amount by which the cost of such property exceeds \$2 million. Further limitations on the ability to immediately expense this amount may apply based on the business’s taxable income for the year.

Section 179 property includes tangible personal property with a recovery period of 20 years or less under MACRS, certain off-the-shelf computer software, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property.

**Provision:** Under the provision, the small business expensing limitation under section 179 would be increased to \$5 million and the phase-out amount would be increased to \$20 million. The provision would modify the expensing limitation by indexing both the \$5 million and \$20 million limits for inflation. The provision would modify the definition of section 179 property to include qualified energy efficient heating and air-conditioning property permanently. The provision to modify the definition of section 179 property to include qualified energy efficient heating and air-conditioning property would be effective for property acquired and placed in service after November 2, 2017. The provision to increase the dollar limitations would be effective for tax years beginning after 2017 through tax years beginning before 2023.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$11.4 billion over 2018-2027.

### **Sec. 3202. Small business accounting method reform and simplification.**

#### **Current law:**

##### *Cash Method of Accounting*

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 expense. Under current law, businesses structured as sole proprietorships, partnerships (without a corporate partner), and S corporations generally may use the cash method of accounting. Businesses structured as corporations and partnerships with a corporate partner may only use the cash method of accounting if its average gross receipts do not exceed \$5 million for all prior years (including the prior taxable years of any predecessor of the entity). Farm corporations and farm partnerships with a corporate partner may only use the cash method of accounting if their gross receipts do not exceed \$1 million in any year. An exception allows certain family farm corporations to qualify if its gross receipts do not exceed \$25 million.

##### *Accounting for Inventories*

Under current law, businesses are required to use an inventory method if the production, purchase, or sale of merchandise is a material income-producing factor to the business. Businesses that are required to use an inventory method must also use the accrual method of accounting for tax purposes. An exception from the accrual method of accounting is provided for certain small businesses with average gross receipts of not more than \$1 million, and a second exception is provided for businesses in certain industries (which are not otherwise prohibited from using the cash method) whose annual gross receipts do not exceed \$10 million. Businesses that fall within these exceptions may also account for inventory as materials and

supplies that are not incidental (*i.e.*, “non-incident materials and supplies”) under applicable Treasury regulations.

### *Capitalization and Inclusion of Certain Expenses in Inventory Costs*

The uniform capitalization (UNICAP) rules generally require certain direct and indirect costs associated with real or tangible personal property manufactured by a business to be included in either inventory or capitalized into the basis of such property, as applicable. Additionally, for real or personal property acquired by a business for resale, the UNICAP rules generally require certain direct and indirect costs allocable to such property to be included in inventory. Under current law, a business with \$10 million or less of average annual gross receipts is not subject to the UNICAP rules with respect to personal property acquired for resale. This exception to the UNICAP rules does not apply to real and personal property that is manufactured by the business.

### *Accounting for Long-term Contracts*

Under current law, the taxable income from a long-term contract generally is determined under the percentage-of-completion method, which allows for deductions and income recognition based on the percentage of the contract that is completed each taxable year. A taxpayer determines the percentage of the contract completed during the year by comparing the contract costs that were incurred during the year with the estimated total contract costs.

An exception from the requirement to use the percentage-of-completion method is provided for certain businesses with average annual gross receipts of \$10 million or less in the preceding three years. Under this exception, a business may use the completed contract method with respect to contracts that are expected to be completed within a two year period. Under the completed contract method, a business is permitted to deduct costs associated with the construction when they are paid and recognize income when the contract is completed.

### **Provision:**

#### *Cash Method of Accounting*

Under the provision, the \$5 million threshold for corporations and partnerships with a corporate partner would be increased to \$25 million and the requirement that such businesses satisfy the requirement for all prior years would be repealed. The increased \$25 million threshold would be extended to farm corporations and farm partnerships with a corporate partner, as well as family farm corporations. Also under the provision, the average gross receipts test would be indexed to inflation.

#### *Accounting for Inventories*

Under the provision, businesses with average gross receipts of \$25 million or less would be permitted to use the cash method of accounting even if the business has inventories. Under the cash method of accounting, a business may account for inventory as non-incident materials and supplies. Under the provision, a business with inventories that qualifies for and uses the cash

method of accounting would be able to account for its inventories using its method of accounting reflected on its financial statements or its books and records.

#### *Capitalization and Inclusion of Certain Expenses in Inventory Costs*

Under the provision, businesses with average gross receipts of \$25 million or less would be fully exempt from the UNICAP rules. This exemption would apply to real and personal property acquired or manufactured by such business.

#### *Accounting for Long-term Contracts*

Under the provision, the \$10 million average gross receipts exception to the percentage-of-completion method would be increased to \$25 million. Businesses that meet the increased average gross receipts test would be permitted to use the completed-contract method (or any other permissible exempt contract method).

The provision would be effective for tax years beginning after 2017.

**Consideration:** This provision would allow businesses greater access to the cash method of accounting, other simplifying accounting method rules, and the exemption from complex UNICAP rules. Additionally, the provision aligns the eligibility to benefits of each of these rules to a single average gross receipts test, which further simplifies these rules for businesses.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$30.0 billion over 2018-2027.

#### **Sec. 3203. Small business exception from limitation on deduction of business interest.**

**Current law:** Under current law, business interest is generally allowed as a deduction in the taxable year in which the interest is paid or accrued, subject to a number of limitations.

**Provision:** Under the provision, businesses with average gross receipts of \$25 million or less would be exempt from the interest limitation rules described in section 3301. The provision would be effective for tax years beginning after 2017.

**Consideration:** This provision would preserve the deduction for business interest expense for small businesses, which generally struggle to finance their business operations and growth through equity capital.

**JCT estimate:** The revenue effect of the provision over 2018-2027 is included in the JCT estimate for section 3301.

## **Subtitle D – Reform of Business-related Exclusions, Deductions, etc.**

### **Sec. 3301. Interest.**

**Current law:** Under current law, business interest generally is allowed as a deduction in the taxable year in which the interest is paid or accrued, subject to a number of limitations. For example, limitations on interest expense exist for certain amounts paid in connection with insurance and annuity contracts, while other disallowances exist with respect to interest payments between related taxpayers. Other limitations on the deductibility of interest expense, in general, exist to disallow certain amounts of interest paid in connection with tax-exempt interest, passive interest, investment interest, and qualified residence interest.

Under current law, Code section 163(j) limits the ability of a corporation to deduct disqualified interest (generally, interest paid or accrued to a related party when no Federal income tax is imposed with respect to the interest) paid or accrued in a taxable year if two threshold tests are satisfied: (1) the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio); and (2) the payor's net interest expense exceeds 50 percent 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 percent of the adjusted taxable income of the payor over the payor's net interest expense) can be carried forward three years.

**Provision:** Under the provision, every business, regardless of its form, would be subject to a disallowance of a deduction for net interest expense in excess of 30 percent 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, net operating losses, and depreciation, amortization, and depletion. Any interest amounts disallowed under the provision would be carried forward to the succeeding five taxable years and would be an attribute of the business (as opposed to its owners). Special rules would apply to allow a pass-through entity's unused interest limitation for the taxable year to be used by the pass-through entity's owners and to ensure that net income from pass-through entities would not be double counted at the partner level.

The provision, as amended by the provision under section 3204, would provide an exemption from these rules for businesses with average gross receipts of \$25 million or less. Additionally, the provision would not apply to certain regulated public utilities and real property trades or businesses. These businesses would be ineligible for full expensing in section 3101.

The provision would also repeal current law Code section 163(j). The provision would be effective for tax years beginning after 2017.

**Considerations:**

- Today, for a C corporation, the after-tax effect of debt financing is more favorable than equity financing because of the deductibility of interest.
- Interest deductions may create a negative income tax rate for corporate income when combined with depreciation deductions, credits, preferential rates, or tax exemption of the earnings financed with debt.
- Many countries around the world, such as Germany, have similar rules on limitations on interest expense on third party debt and thin-capitalization rules.

**JCT estimate:** According to JCT, the provision would increase revenues by \$172 billion over 2018-2027.

**Sec. 3302. Modification of net operating loss deduction.**

**Current law:** Under current law, a net operating loss (NOL) generally is the amount by which a taxpayer's current-year business deductions exceed its current-year gross income. NOLs may not be deducted in the year generated, but may be carried back two years and carried forward 20 years to offset taxable income in such years. The alternative minimum tax (AMT) rules provide that a taxpayer's NOL deduction may not reduce the taxpayer's alternative minimum taxable income by more than 90 percent.

Different rules apply with respect to NOLs arising in certain circumstances. A special five-year carryback applies to NOLs arising from a farming loss, losses arising from certain bad debts of commercial banks, and certain amounts related to disaster relief. Special rules also apply to specified liability losses (ten-year carryback) and excess interest losses (no carryback to any year preceding a corporate equity reduction transaction). Additionally, a special rule applied to losses incurred in 2008 and 2009 (up to a five-year carryback) and a special rule applied to certain electric utility companies with respect to NOLs arising in 2003 through 2005 (five-year carryback).

**Provision:** Under the provision, taxpayers would be able to deduct an NOL carryover or carryback only to the extent of 90 percent of the taxpayer's taxable income (determined without regard to the NOL deduction) – conforming to the current-law AMT rule. The provision also would generally repeal all carrybacks but provide a special one-year carryback for small businesses and farms in the case of certain casualty and disaster losses. The provision generally would be effective for losses arising in tax years beginning after 2017. In the case of any net operating loss, specified liability loss, excess interest loss or eligible loss, carrybacks would be permitted in a taxable year beginning in 2017, as long as the NOL is not attributable to the increased expensing that would be allowed under section 3101. Additionally, the provision would allow NOLs arising in tax years beginning after 2017 and that are carried forward to be increased by an interest factor to preserve its value.

**JCT estimate:** According to JCT, the provision would increase revenues by \$156 billion over 2018-2027.



### **Sec. 3303. Like-kind exchanges of real property.**

**Current law:** Under current law, an exchange of property, like a sale, generally is a taxable transaction. A special rule provides that no gain or loss is recognized to the extent that property held for productive use in the taxpayer's trade or business, or property held for investment purposes, is exchanged for property of a like-kind that also is held for productive use in a trade or business or for investment. The taxpayer receives a basis in the new property equal to the taxpayer's adjusted basis in the exchanged property. The like-kind exchange rule applies to a wide range of property from real estate to tangible personal property. It does not apply, however, to exchanges of stock in trade or other property held primarily for sale, stocks, bonds, partnership interests, certificates of trust or beneficial interest, other securities or evidences of indebtedness or interest, or to certain exchanges involving livestock or involving foreign property. A like-kind exchange does not require that the properties be exchanged simultaneously – as long as the property to be received in the exchange is identified within 45 days and ultimately received within 180 days of the sale of the original property, gain is deferred.

**Provision:** Under the provision, the special rule allowing deferral of gain on like-kind exchanges would be modified to allow for like-kind exchanges only with respect to real property. The provision would be effective for transfers after 2017. However, the provision would provide a transition rule to allow like-kind exchanges of personal property to be completed if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before December 31, 2017.

#### **Considerations:**

- The like-kind exchange rules currently allow taxpayers to defer tax on the built-in gains in property by exchanging it for similar property. With multiple exchanges, gains essentially may be deferred for decades, and ultimately escape taxation entirely if the property's basis is stepped up to its fair market value upon the death of the owner.
- The bill provides full expensing for most tangible personal property which provides a marginal effective tax rate of zero percent to fully expensed property, equating to the deferral that like-kind exchanges provide currently.

**JCT estimate:** According to JCT, the provision would increase revenues by \$30.5 billion over 2018-2027.

### **Sec. 3304. Revision of treatment of contributions to capital.**

**Current law:** Under current law, the gross income of a corporation generally does not include contributions to its capital (*i.e.*, transfers of money or property to the corporation by a non-shareholder such as a government entity). In addition, a corporation does not recognize gain or loss on the receipt of money or property in exchange for stock of the corporation.

**Provision:** Under the provision, the gross income of a corporation would include contributions to its capital, to the extent the amount of money and fair market value of property contributed to

the corporation exceeds the fair market value of any stock that is issued in exchange for such money or property. Similar rules would apply to contributions to the capital of any non-corporate entity, such as a partnership. The provision would be effective for contributions made, and transactions entered into, after the date of enactment.

**Consideration:** This provision would remove a Federal tax subsidy for State and local governments to offer incentives and concessions to businesses that locate operations within their jurisdiction (usually in lieu of locating operations in a different State or locality).

**JCT estimate:** According to JCT, the provision would increase revenues by \$7.4 billion over 2018-2027.

### **Sec. 3305. Repeal of deduction for local lobbying expenses.**

**Current law:** Under current law, businesses generally may deduct ordinary and necessary expenses paid or incurred in connection with carrying on any trade or business. An exception to the general rule, however, disallows deductions for lobbying and political expenditures with respect to legislation and candidates for office, except for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments).

**Provision:** Under the provision, deductions for lobbying expenses with respect to legislation before local government bodies (including Indian tribal governments) would be disallowed. The provision would be effective for amounts paid or incurred after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.8 billion over 2018-2027.

### **Sec. 3306. Repeal of deduction for income attributable to domestic production activities.**

**Current law:** Under current law, taxpayers may claim a deduction equal to 9 percent (6 percent in the case of certain oil and gas activities) of the lesser of the taxpayer's qualified production activities income or the taxpayer's taxable income for the tax year. The deduction is limited to 50 percent of the W-2 wages paid by the taxpayer during the calendar year. Qualified production activities income is equal to domestic production gross receipts less the cost of goods sold and expenses properly allocable to such receipts. Qualifying receipts are derived from property that was manufactured, produced, grown, or extracted within the United States; qualified film productions; production of electricity, natural gas, or potable water; construction activities performed in the United States; and certain engineering or architectural services. Qualifying receipts do not include gross receipts derived from the sale of food or beverages prepared at a retail establishment; the transmission or distribution of electricity, gas, and potable water; or the disposition of land.

**Provision:** Under the provision, the deduction for domestic production activities would be repealed for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$95.2 billion over 2018-2027.

### **Sec. 3307. Entertainment, etc. expenses.**

**Current law:** Under current law, no deduction is allowed for expenses relating to entertainment, amusement or recreation activities, or facilities (including membership dues with respect to such activities or facilities), unless the taxpayer establishes that the item was directly related to the active conduct of the taxpayer's trade or business, in which case the taxpayer may deduct up to 50 percent of expenses relating to meals and entertainment. An item is considered directly related if it is associated with a substantial and bona fide business discussion.

A taxpayer also may deduct the cost of certain fringe benefits provided to employees (*e.g.*, employee discounts, working condition, and transportation fringe benefits), even though such benefits are excluded from the employee's income under Code section 132. Additionally, a taxpayer may deduct expenses for goods, services, and facilities to the extent that the expenses are reported by the taxpayer as compensation and wages to an employee (or includible in gross income of a recipient who is not an employee).

A taxpayer may deduct certain reimbursed expenses, including reimbursement arrangements in which an employer reimburses the expenses incurred by employees of a subcontractor, provided such expenses are properly substantiated and not treated as income to the employee.

**Provision:** Under the provision, no deduction would be allowed for entertainment, amusement or recreation activities, facilities, or membership dues relating to such activities or other social purposes. In addition, no deduction would be allowed for transportation fringe benefits, benefits in the form of on-premises gyms and other athletic facilities, or for amenities provided to an employee that are primarily personal in nature and that involve property or services not directly related to the employer's trade or business, except to the extent that such benefits are treated as taxable compensation to an employee (or includible in gross income of a recipient who is not an employee). The 50-percent limitation under current law also would apply only to expenses for food or beverages and to qualifying business meals under the provision, with no deduction allowed for other entertainment expenses. Furthermore, no deduction would be allowed for reimbursed entertainment expenses paid as part of a reimbursement arrangement that involves a tax-indifferent party such as a foreign person or an entity exempt from tax. The provision would be effective for amounts paid or incurred after 2017.

### **Considerations:**

- It is difficult for the IRS to determine whether entertainment expenses are directly related to a trade or business, creating uncertainty for taxpayers as well as the potential for significant abuse.

- The provision aligns the treatment of transportation fringe benefits, benefits in the form of on-premises gyms and other athletic facilities, and amenities provided to an employee that are primarily personal in nature and not directly related to a trade or business with other similar tax items.

**JCT estimate:** According to JCT, the provision, along with section 3308, would increase revenues by \$33.8 billion over 2018-2027.

**Sec. 3308. Unrelated business taxable income increased by amount of certain fringe expenses for which deduction is disallowed.**

**Current law:** Under current law, tax-exempt entities are situated similarly to taxable entities with regard to providing their employees with transportation fringe benefits, and on-premises gyms and other athletic facilities, as such benefits pass from the employer to the employee free of tax at both levels. Employers subject to Federal income tax may deduct the costs of such benefits, with tax-exempt entities not needing to deduct the costs of such benefits, and their employees may exclude the values of such benefits from their taxable incomes.

**Provision:** Under the provision, tax-exempt entities would be taxed on the values of providing their employees with transportation fringe benefits, and on-premises gyms and other athletic facilities, by treating the funds used to pay for such benefits as unrelated business taxable income, thus subjecting the values of those employee benefits to a tax equal to the corporate tax rate. The provision would be effective for amounts paid or incurred after 2017.

**Considerations:** Treating the non-deductibility of certain employee benefits similarly between tax-exempt entities and taxable entities is necessary for creating parity between the different types of entities so that one does not have an advantage over the other with regard to recruiting and retaining employees.

**JCT estimate:** The revenue effect of the provision over 2018-2027 is included in the JCT estimate provided for section 3307.

**Sec. 3309. Limitation on deduction for FDIC premiums.**

**Current law:** Under current law, amounts paid by insured depository institutions pursuant to an assessment by the Federal Deposit Insurance Corporation (FDIC) to support the Deposit Insurance Fund (DIF) are currently deductible as a trade or business expense.

**Provision:** Under the provision, a percentage of such assessments would be non-deductible for institutions with total consolidated assets in excess of \$10 billion. The percentage of non-deductible assessments would be equal to the ratio that total consolidated assets in excess of \$10 billion bears to \$40 billion, so that assessments would be completely non-deductible for institutions with total consolidated assets in excess of \$50 billion. The provision would be effective for tax years beginning after 2017.

**Consideration:** The provision corrects for the fact that, when the FDIC determines the amount of assessments that are necessary to maintain an adequate balance in the DIF, it does so on a pre-tax basis and does not take into account the deductibility of the premium payments. These deductions diminish the General Fund and effectively result in a General Fund transfer to the DIF.

**JCT estimate:** According to JCT, the provision would increase revenues by \$13.7 billion over 2018-2027.

**Sec. 3310. Repeal of rollover of publicly traded securities gain into specialized small business investment companies.**

**Current law:** Under current law, gain or loss generally is recognized on any sale, exchange, or other disposition of property. A special rule permits an individual or corporation to roll over without recognition of income any capital gain realized on the sale of publicly traded securities when the proceeds are used to purchase common stock or a partnership interest in a specialized small business investment corporation (SSBIC) within 60 days of the sale of the securities. SSBICs are a special type of investment fund licensed by the U.S. Small Business Administration until 1996 when the program was repealed (though certain existing SSBICs were grandfathered). The amount of gain that a taxpayer may roll over in a tax year is limited to the lesser of (1) \$50,000 (\$250,000 for corporations) or (2) \$500,000 (\$1,000,000 for corporations) reduced by the gain previously excluded under the provision.

**Provision:** Under the provision, the special rule permitting gains on publicly traded securities to be rolled over to an SSBIC would be repealed. The provision would be effective for sales after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.7 billion over 2018-2027.

**Sec. 3311. Certain self-created property not treated as a capital asset.**

**Current law:** Under current law, a self-created patent, invention, model or design (whether or not patented), or secret formula or process is treated as a capital asset. However, the following self-created property is not treated as a capital asset: copyrights; literary, musical or artistic compositions; and letters or memoranda. Any gain or loss recognized as a result of the sale, exchange, or other disposition of such property is generally ordinary in character. The creator of musical compositions or copyrights in musical works, however, may elect to treat such property as a capital asset.

**Provision:** Under the provision, gain or loss from the disposition of a self-created patent, invention, model or design (whether or not patented), or secret formula or process would be ordinary in character. This would be consistent with the treatment of copyrights under current

law. In addition, the election to treat musical compositions and copyrights in musical works as a capital asset would be repealed. The provision would be effective for dispositions of such property after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.5 billion over 2018-2027.

### **Sec. 3312. Repeal of special rule for sale or exchange of patents.**

**Current law:** Under current law, an individual who creates a patent and an unrelated individual who acquires a patent from its creator prior to the actual commercial use of the patent may treat any gains on the transfer of the patent as long-term capital gains. To qualify, a transfer must be of substantially all the rights to the patent (or an undivided interest therein) and cannot be by gift, inheritance or devise.

**Provision:** Under the provision, the special rule treating the transfer of a patent prior to its commercial exploitation as long-term capital gain would be repealed. The provision would be effective for dispositions after 2017.

**JCT estimate:** The revenue effect of the provision over 2018-2027 is included in the JCT estimate provided for section 3311.

### **Sec. 3313. Repeal of technical termination of partnerships.**

**Current law:** Under current law, a partnership terminates only if: (1) no part of any business, financial operations, or venture of the partnership continues to be carried on by any of its partners, or (2) within a 12-month period there is a sale or exchange of 50 percent or more of the total interests in partnership capital and profits. The second type of termination is commonly referred to as a technical termination. When a technical termination occurs, the business of the partnership continues in the same legal form, but the partnership is treated as newly formed and must make new elections for various accounting methods, depreciation lives, and other purposes.

**Provision:** Under the provision, the technical termination rule would be repealed. Thus, the partnership would be treated as continuing even if more than 50 percent of the total capital and profits interests of the partnership are sold or exchanged, and new elections would not be required or permitted. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.7 billion over 2018-2027.

## **Subtitle E – Reform of Business Credits**

### **Sec. 3401. Repeal of credit for clinical testing expenses for certain drugs for rare diseases or conditions.**

**Current law:** Under current law, a drug manufacturer may claim a credit equal to 50 percent of qualified clinical testing expenses.

**Provision:** Under the provision, the credit for clinical testing expenses for certain drugs for rare diseases or conditions would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$54.0 billion over 2018-2027.

### **Sec. 3402. Repeal of employer-provided child care credit.**

**Current law:** Under current law, an employer may claim a credit equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child-care resource and referral services. The credit is limited to \$150,000 per tax year.

**Provision:** Under the provision, the credit for employer-provided child care would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.2 billion over 2018-2027.

### **Sec. 3403. Repeal of rehabilitation credit.**

**Current law:** Under current law, a taxpayer may claim a credit for expenses incurred to rehabilitate old and/or historic buildings. A 20-percent credit is allowed for qualified rehabilitation expenditures with respect to a certified historic structure, while a 10-percent credit is allowed for qualified rehabilitation expenditures with respect to a qualified rehabilitated building. To qualify for the 10-percent credit, the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the tax year must exceed the greater of the adjusted basis of the building (and its structural components) or \$5,000.

**Provision:** Under the provision, the rehabilitation credit would be repealed. Under a transition rule, the credit would continue to apply to expenditures incurred through the end of a 24-month period of qualified expenditures, which would have to begin within 180 days after January 1, 2018.

**JCT estimate:** According to JCT, the provision would increase revenues by \$9.3 billion over 2018-2027.

#### **Sec. 3404. Repeal of work opportunity tax credit.**

**Current law:** Under current law, an employer may claim a credit equal to 40 percent of qualified first-year wages of employees belonging to certain targeted groups. Such qualified wages are subject to various limits between \$6,000 and \$24,000, varying by the specific targeted group.

**Provision:** Under the provision, the work opportunity tax credit would be repealed. The provision would be effective for wages paid or incurred to individuals who begin work after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$3.6 billion over 2018-2027.

#### **Sec. 3405. Repeal of deduction for certain unused business credits.**

**Current law:** Under current law, a taxpayer may carry unused business credits back one year and forward 20 years. However, a taxpayer generally may not deduct unused credits after dying or, in the case of a business taxpayer, ceasing to exist.

**Provision:** Under the provision, the deduction for unused business credits would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would have a negligible effect on revenues over 2018-2027.

#### **Sec. 3406. Termination of new markets tax credit.**

**Current law:** Under current law, certain qualifying taxpayers may claim a 5-percent credit per year for the first three years of investments in, and a 6-percent credit per year for the next four years of investments in qualified community development entities, which generally intend to serve low-income communities and low-income individuals.

**Provision:** Under the provision, no additional new markets tax credits would be allocated after 2017; however, credits that would have already been allocated may be used over the course of up to seven years as contemplated by the credit's multi-year timeline.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.7 billion over 2018-2027.



### **Sec. 3407. Repeal of credit for expenditures to provide access to disabled individuals.**

**Current law:** Under current law, small-business taxpayers may claim a 50 percent credit per year for expenditures of between \$250 and \$10,250 for providing access to disabled individuals. A small business for this purpose is defined as a business with no more than \$1,000,000 in gross receipts or employing no more than 30 full-time employees.

**Provision:** Under the provision, the credit for expenditures to provide access to disabled individuals would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.3 billion over 2018-2027.

### **Sec. 3408. Modification of credit for portion of employer social security taxes paid with respect to employee tips.**

**Current law:** Under current law, an employer may claim an income tax credit equal to its share of FICA taxes attributable to tips received from customers in connection with the provision of food or beverages if tipping is customary for that employer's customers. The credit is available only to the extent such tips exceed the amount of tips that the employer uses to meet the minimum wage requirements for the employee under the Fair Labor Standards Act, as it was on January 1, 2007, namely \$5.15 per hour. An employer may not claim a deduction for any amount taken into account in determining the credit.

**Provision:** Under the provision, this credit would be modified to reflect the current minimum wage so that it is available with regard to tips reported only above the current minimum wage rather than tips above \$5.15 per hour. Additionally, all restaurants claiming the credit would be required to report to the Internal Revenue Services tip allocations among tipped employees (allocations at no less than 10 percent of gross receipts per tipped employee rather than 8 percent), which is a reporting requirement now required only of restaurants with at least ten employees. This provision would be effective for tips received for services performed after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$3.9 billion over 2018-2027.

## **Subtitle F – Energy Credits**

### **Sec. 3501. Modifications to credit for electricity produced from certain renewable resources.**

**Current law:** Under current law, a taxpayer may claim a production tax credit (PTC) for the production of electricity from qualified energy resources at a qualified facility during the 10-year

period beginning on the date the facility was originally placed in service. Qualified energy resources consist of wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. To be eligible for the PTC, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person. The base amount of the PTC is 1.5 cents (indexed annually for inflation) per kilowatt-hour of electricity produced. The amount of the credit is generally 2.3 cents per kilowatt-hour for 2016. The PTC generally is available for wind facilities the construction of which begins before 2020 and for other facilities the construction of which began before 2017.

**Provision:** Under the provision, the inflation adjustment would be repealed, effective for electricity and refined coal produced at a facility the construction of which begins after November 2, 2017. Therefore, taxpayers' credit amount would revert to 1.5 cents per kilowatt-hour for the remaining portion of the 10-year period. Additionally, the provision would clarify that the construction of any facility, modification, improvement, addition, or other property may not be treated as beginning before any date unless there is a continuous program of construction which begins before such date and ends on the date that such property is placed in service. This clarification applies to tax years beginning before, on, or after November 2, 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$12.3 billion over 2018-2027.

### **Sec. 3502. Modification of the energy investment tax credit.**

**Current law:** Under current law, a taxpayer may claim an investment tax credit (ITC) for a percentage of the basis of eligible energy property when placed in service. Eligible energy property consists of solar energy, fiber-optic solar energy, geothermal energy, qualified fuel cell, qualified microturbine, combined heat and power system, qualified small wind energy, and thermal energy properties. In addition, certain property that is part of a qualified facility for purposes of the production tax credit (described with respect to section 3502 of the bill) may constitute eligible energy property provided no production tax credit is taken with respect to such property.

In general, a 30 percent ITC is available for solar energy property the construction of which begins before 2020, which is then phased down for property the construction of which begins before 2022, with a 10 percent ITC available for solar energy property the construction of which begins after 2021.

In general, a 30 percent ITC is available for qualified wind facility property the construction of which begins before 2017, which is then phased out for property the construction of which begins before 2020, with no ITC available for qualified wind facility property the construction of which begins after 2019.

A 30 percent ITC is generally available for fiber-optic solar energy property the construction of which begins before 2022 and for qualified fuel cell, qualified small wind energy, and qualified

non-wind facility property the construction of which begins before 2017. A 10 percent ITC is generally available for qualified microturbine, combined heat and power system, and thermal energy property the construction of which begins before 2017. And a 10 percent ITC is generally available for geothermal energy property regardless of when construction begins.

**Provision:** The provision generally harmonizes the expiration dates and phase-out schedules for different properties. Accordingly, under the provision, the 30 percent ITC for solar energy, fiber-optic solar energy, qualified fuel cell, and qualified small wind energy property is available for property the construction of which begins before 2020 and is then phased out for property the construction of which begins before 2022, with no ITC available for property the construction of which begins after 2021. Additionally, the 10 percent ITC for qualified microturbine, combined heat and power system, and thermal energy property is made available for property the construction of which begins before 2022. Finally, the permanent 10 percent ITC available for solar energy and geothermal energy property are eliminated for property the construction of which begins after 2027.

Additionally, the provision would clarify that the construction of any facility, modification, improvement, addition, or other property may not be treated as beginning before any date unless there is a continuous program of construction which begins before such date and ends on the date that such property is placed in service. This clarification applies to tax years beginning before, on, or after November 2, 2017.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$1.2 billion over 2018-2027.

### **Sec. 3503. Extension and phaseout of residential energy efficient property.**

**Current law:** Under current law, a taxpayer may claim a credit for the purchase of qualified solar electric property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs. The credit is equal to 30 percent of qualifying expenditures. There also is a 30-percent credit for the purchase of qualified geothermal heat pump property, qualified small wind energy property, and qualified fuel cell power plants. The credit applies to property placed in service prior to 2017, and to qualified solar electric property placed in service prior to 2022 (subject to a reduced rate of 26 percent for property placed in service during 2020 and 22 percent for property placed in service during 2021).

**Provision:** Under the provision, the credit for residential energy efficient property would be extended for all qualified property placed in service prior to 2022, subject to a reduced rate of 26 percent for property placed in service during 2020 and 22 percent for property placed in service during 2021. The provision would be effective for property placed in service after 2016.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$1.1 billion over 2018-2027.

#### **Sec. 3504. Repeal of enhanced oil recovery credit.**

**Current law:** Under current law, taxpayers may claim a credit equal to 15 percent of enhanced oil recovery (EOR) costs. The EOR credit is ratably reduced over a \$6 phase-out range when the reference price for domestic crude oil exceeds \$28 per barrel (adjusted for inflation after 1991). The EOR credit currently is phased-out based on the current price of a barrel of oil.

**Provision:** Under the provision, the enhanced oil recovery credit would be repealed. The provision would be effective for tax years after 2017.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$0.2 billion 2018-2027.

#### **Sec. 3505. Repeal of credit for producing oil and gas from marginal wells.**

**Current law:** Under current law, producers may claim a \$3-per-barrel credit (adjusted for inflation) for the production of crude oil and a 50-cents-per-1,000-cubic-foot credit (also adjusted for inflation) for the production of qualified natural gas. In both cases, the credit is available only for domestic production. The credit is not available for production if the reference price of oil exceeds \$18 (\$2 for natural gas). The credit is reduced proportionately for reference prices between \$15 and \$18 (\$1.67 and \$2 for natural gas). Currently, the credit is phased out completely based on the current price of a barrel of oil.

**Provision:** Under the provision, the credit would be repealed. The provision would be effective for tax years after 2017.

**JCT estimate:** According to JCT, the provision would have no revenue effect over 2018-2027.

#### **Sec. 3506. Modifications of credit for production from advanced nuclear power facilities.**

**Current Law:** Under current law, taxpayers may claim a credit for electricity produced at a qualifying advanced nuclear power facility for an 8-year period beginning on the date such facility is placed in service. The credit provides for a maximum 6,000 megawatts of national capacity, to be allocated by the Secretary of the Treasury, which effectively caps the credits available. To qualify, a taxpayer must have submitted an application with respect to a nuclear facility before February 1, 2014, pursuant to IRS Notice 2013-68, and must subsequently have received an allocation from the available national megawatt capacity with respect to the facility. As of 2017, the Secretary of the Treasury has allocated all 6,000 megawatts of national capacity. The credit also is capped at a maximum value on an annual basis. As is the case with respect to other tax credits, nuclear production tax credits may be allocated among partners in a partnership, effectively allowing for the transfer of such credits in certain circumstances.

**Provision:** Under the provision, the credit allocation process would be clarified and a new credit transfer provision would be added with respect to certain public entities. Beginning after January 1, 2021, the Secretary of the Treasury would re-allocate any national megawatt capacity that remains unused under the cap, first to qualifying facilities to the extent such facilities did not receive an allocation equal to their full capacity and then to facilities placed in service after such date in the order in which such facilities are placed in service. In addition, certain public entities would be eligible for an election to transfer advanced nuclear production tax credits to specified project participants that are persons participating in design or construction, persons providing nuclear steam supply systems or nuclear fuel, persons with an ownership interest, and partners in a partnership with an ownership interest. The clarification to the credit allocation process would be effective on the date of enactment, and the change related to credit transfers would be effective for tax years beginning after date of enactment.

**Considerations:**

- The legislation would ensure that the 6,000 megawatt national capacity is fully utilized as intended by Congress. That limitation would remain in place, and no new credits would be available.
- Although current partnership rules allow for some allocations of credits, the updated transfer mechanism would ensure that the credits can be fully utilized as intended by Congress.

**JCT Estimate:** According to JCT, the provision would reduce revenues by \$0.4 billion over 2018-2027.

## **Subtitle G – Bond Reforms**

### **Sec. 3601. Termination of private activity bonds.**

**Current law:** Under current law, interest on both governmental bonds and private activity bonds (PABs) is excluded from gross income (and thus exempt from tax). Governmental bonds typically are issued to finance projects that constitute public goods (*e.g.*, roads, schools, and parks). By contrast, the proceeds of PABs finance the activities of, or loans to, private parties, with indirect benefits accruing to the State or locality that issues the bond. The exclusion of interest on PABs generally is disallowed under the alternative minimum tax (AMT), meaning that AMT payers pay tax on such interest. Only specific categories of PABs qualify for the tax preference. Those categories include exempt facility bonds, qualified mortgage bonds, qualified veterans' mortgage bonds, qualified small issue bonds, qualified student loan bonds, qualified redevelopment bonds, and qualified 501(c)(3) bonds. Most PABs are subject to a single, aggregate national volume cap that is allocated annually among States by population, while other PABs have separate volume caps. For calendar year 2017, the per-State volume cap is the greater of (1) \$100 multiplied by the State population, or (2) \$305,315,000. These amounts are indexed for inflation.

Some State and local governments issue PABs to finance owner-occupied residences. In lieu of issuing such bonds, State and local governments may provide homebuyers a Federal tax credit for interest on certain home mortgages by providing them with mortgage credit certificates.

**Provision:** Under the provisions, interest on newly issued PABs would be included in income and thus subject to tax. The provisions would be effective for bonds issued after 2017.

**Considerations:**

- The Federal government should not subsidize the borrowing costs of private businesses, allowing them to pay lower interest rates while competitors with similar creditworthiness but that are unable to avail themselves of PABs must pay a higher interest rate on the debt they issue.
- The provisions would not apply to any previously issued bond, nor would the provisions prevent State and local governments from issuing PABs in the future; the provisions would merely remove the Federal tax subsidy for newly issued bonds.

**JCT estimate:** According to JCT, the provisions would increase revenues by \$38.9 billion over 2018-2027.

**Sec. 3602. Repeal of advance refunding bonds.**

**Current law:** Under current law, 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 is issued more than 90 days before the redemption of the refunded bond. Interest on current refunding bonds is generally not taxable. Interest on advance refunding bonds is generally not taxable for governmental bonds but is taxable for PABs.

**Provision:** Under the provision, interest on advance refunding bonds (*i.e.*, refunding bonds issued more than 90 days before the redemption of the refunded bonds) would be taxable. Interest on current refunding bonds would continue to be tax-exempt. The provision would be effective for advance refunding bonds issued after 2017.

**Considerations:**

- Current-law advance refunding bonds provide State and local governments with incentives to issue two sets of Federally subsidized debt to finance the same activity.
- The provision would not affect the taxation of interest on refunding bonds issued within 90 days of the redemption of the refunded bond.

**JCT estimate:** According to JCT, the provision would increase revenues by \$17.3 billion over 2018-2027.

**Sec. 3603. Repeal of tax credit bonds.**

**Current law:** Under current law, State and local governments and other entities may issue various categories of tax credit bonds to finance specific types of projects. Each category of tax credit bond has its own set of rules regarding volume cap, if any, and allocation. Holders of tax

credit bonds receive Federal tax credits fully or partially in lieu of interest payments from the issuer, depending on the level of Federal subsidy. For some of these bonds, during 2009 and 2010, issuers had the option of instead issuing taxable bonds and receiving direct payments from the Federal government.

The authority to issue some types of tax credit bonds has expired, and the volume cap to issue some of these bonds has been fully used. There are some types of tax credit bonds for which there is still an outstanding volume cap and issuing authority has not expired.

**Provision:** Under the provision, the rules relating to tax credit bonds generally would be repealed. Holders and issuers would continue receiving tax credits and payments for tax credit bonds already issued, but no new bonds could be issued. The provision would be effective for bonds issued after 2017.

**JCT estimate:** According to JCT, the provisions would reduce revenues by \$0.5 billion over 2018-2027.

#### **Sec. 3604. No tax exempt bonds for professional stadiums.**

**Current law:** Under current law, State and local governments may issue public purpose bonds, interest on which is excluded from Federal tax. In contrast, the interest on private activity bonds issued by State and local governments, but which benefit private individuals or entities, is generally subject to Federal tax unless such bonds are deemed qualified by meeting very specific criteria. Examples include exempt facility bonds, qualified mortgage bonds, qualified veterans' mortgage bonds, qualified small issue bonds, qualified student loan bonds, qualified redevelopment bonds, and qualified 501(c)(3) bonds. Professional sports stadiums do not generally meet any of these criteria. Nonetheless, some State and local governments have issued bonds and successfully taken the position that interest on the bonds is exempt from Federal tax because the bonds are public purpose bonds.

**Provision:** Under the provision, interest on bonds issued to finance the construction of, or capital expenditures for, a professional sports stadium would be subject to Federal tax. A professional sports stadium is any facility that is used as a stadium or arena for professional sports exhibitions, games or training for at least five days in any calendar year. The provision would be effective for bonds issued after the date of introduction.

**JCT estimate:** According to JCT, the provisions would increase revenues by \$0.2 billion over 2018-2027.

## **Subtitle H – Insurance**

### **Sec. 3701. Net operating losses of life insurance companies.**

**Current law:** Under current law, net operating losses of a trade or business generally may be carried back up to two tax years or carried forward up to 20 tax years. In the case of life insurance companies, however, net operating losses may be carried back up to three tax years or carried forward up to 15 tax years.

**Provision:** Under the provision, life insurance companies would be allowed to carry net operating losses back up to two tax years or forward up to 20 tax years, in conformity with the general net operating loss carryover rules. The provision would be effective for losses arising in tax years beginning after 2017.

**JCT estimate:** The revenue effect of the provision over 2018-2027 is included in the JCT estimate provided for section 3302.

### **Sec. 3702. Repeal of small life insurance company deduction.**

**Current law:** Under current law, life insurance companies may deduct 60 percent of their first \$3 million of life insurance-related income. The deduction is phased out for companies with income between \$3 million and \$15 million. In addition, the deduction is not available to life insurance companies with assets of at least \$500 million.

**Provision:** Under the provision, the special deduction for small life insurance companies would be repealed. The provision would be effective for tax years beginning after 2017.

#### **Consideration:**

- The provision would eliminate a tax subsidy for businesses in a particular industry that is not available to similar businesses in other industries.
- Eliminating this subsidy also would remove a tax preference that is provided to the segment of the insurance industry in which the risk distribution benefits of pooling are the weakest.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.2 billion over 2018-2027.

### **Sec. 3703. Computation of life insurance tax reserves.**

**Current law:** Under current law, life insurance companies may deduct net increases in life insurance company reserves, while net decreases in such reserves are included in gross income. In computing changes in reserves, the life insurance reserve for a contract generally is the greater of the net surrender value of the contract or the reserve determined under rules provided in the Code, which for discounting purposes employ a prescribed interest rate that is equal to the



greater of the applicable Federal rate or the prevailing State assumed interest rate. The “prevailing State assumed interest rate” is equal to the highest assumed interest rate permitted to be used in at least 26 States in computing regulatory life insurance reserves. The discount rate used by property and casualty (P&C) insurance companies for reserves is the average applicable Federal mid-term rate over the 60 months ending before the beginning of the calendar year for which the determination is made.

**Provision:** Under the provision, life insurance companies would take into account a specific percentage, 76.5 percent, of the increase or decrease in reserves for future un-accrued claims [as reported on the insurer's regulatory annual statement and on tax schedule M-3] in computing taxable income. Deficiency reserves, asset adequacy reserves or other types of reserves would not be included. The provision would generally be effective for tax years beginning after 2017. The effect of the provision on computing reserves for contracts issued before the effective date would be taken into account ratably over the succeeding eight tax years.

**Considerations:**

- Insurance regulators have been changing how life insurance companies must calculate and maintain reserves. The current rules in the Tax Code do not provide how reserves measured in the new matter should be taken into account for tax purposes.
- The provision would replace the current-law prescribed reserve rules with rules taking into account reserves on an economically neutral basis. The current-law rule that uses a regulatory-based measurement generally understates income.

**JCT estimate:** According to JCT, the provision would increase revenues by \$14.9 billion over 2018-2027.

**Sec. 3704. Adjustment for change in computing reserves.**

**Current law:** Under current law, taxpayers are required to make adjustments to taxable income when they change a tax accounting method, so that the accounting method change does not result in an omission or duplication of income or expense. For taxpayers other than life insurance companies, an adjustment that reduces taxable income generally is taken into account in the tax year during which the accounting method change occurs, while an adjustment that increases taxable income generally may be taken into account over the course of four tax years, beginning with the tax year during which the accounting method change occurs. For life insurance companies, an adjustment in computing reserves (which is similar to a change in tax accounting method for other businesses) may be taken into account over ten years (regardless of whether the adjustment reduces or increases taxable income).

**Provision:** Under the provision, the special 10-year period for adjustments to take into account changes in computing reserves by life insurance companies would be repealed. As a result, the general rule for making tax accounting method adjustments would apply to changes in computing reserves by life insurance companies. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.2 billion over 2018-2027.

**Sec. 3705. Modification of rules for life insurance proration for purposes of determining the dividends received deduction.**

**Current law:** Under current law, for insurance companies, deductions are limited or disallowed in certain circumstances if they are related to the receipt of exempt income. Under so-called “proration” rules, life insurance companies are required to reduce deductions, including dividends-received deductions and reserve deductions, to account for the fact that a portion of dividends and tax-exempt interest received is used to fund tax-deductible reserves for the companies’ obligations to policyholders. This portion is determined by a formula that computes the respective shares of net investment income that belong to the company and to the policyholders. Current law is unclear as to what methods companies may use to compute the company share.

**Provision:** Under the provision, the company share would be forty percent. The provision would be effective for tax years beginning after 2017.

**Consideration:** The current-law rules for computing net investment income are very complex and essentially based on a previous system of life insurance company taxation that was changed over 30 years ago. The provision would set the industry average of the company share as the company share for tax purposes.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.1 billion over 2018-2027.

**Sec. 3706. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account.**

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

**Provision:** Under the provision, the rules for policyholders’ surplus accounts would be repealed. The provision would generally be effective for tax years beginning after 2017, and any remaining balances would be subject to tax, payable in eight annual installments.

**JCT estimate:** According to JCT, the provision would increase revenues by less than \$50 million over 2018-2027.

**Sec. 3707. Modification of proration rules for property and casualty insurance companies.**

**Current law:** Under current law, deductions are limited or disallowed in certain circumstances if they are related to the receipt of exempt income. Under so-called “proration” rules that reflect the fact that reserves generally are funded in part by certain untaxed income, property and casualty (P&C) insurance companies are required to reduce reserve deductions for losses incurred by 15 percent of (1) the company’s tax-exempt interest, (2) the deductible portion of dividends received, and (3) the increase for the tax year in the cash value of life insurance, endowment, or annuity contracts the company owns.

**Provision:** Under the provision, the 15-percent reduction in the reserve deduction for P&C insurance companies would be increased to 26.25-percent. The provision would be effective for tax years beginning after 2017.

**Consideration:** The provision would keep the reduction in the reserve deduction consistent with current law by adjusting the rate proportionately to the decrease in the corporate tax rate.

**JCT estimate:** According to JCT, the provision would increase revenues by \$2.1 billion over 2018-2027.

**Sec. 3708. Modification of discounting rules for property and casualty insurance companies.**

**Current law:** Under current law, a P&C insurance company may deduct unpaid losses that are discounted using mid-term applicable Federal rates and based on a loss payment pattern. The loss payment pattern for each line of insurance business is determined by reference to the industry-wide historical loss payment pattern applicable to such line of business, although companies may elect to use their own particular historical loss payment patterns.

The loss payment pattern is computed based upon the assumption that all losses are paid (1) in general, during the accident year and the three calendar years following the accident year, or (2) in the case of lines of business relating to auto or other liability, medical malpractice, workers’ compensation, multiple peril lines, international coverage, and reinsurance, during the accident year and the ten calendar years following the accident year. In the case of long-tail lines of business, a special rule extends the loss payment pattern period, so that the amount of losses which would have been treated as paid in the tenth year after the accident year is treated as paid in the tenth year and in each subsequent year (up to five years) in an amount equal to the amount of the losses treated as paid in the ninth year after the accident year.

**Provision:** Under the provision, P&C insurance companies would use the corporate bond yield curve (as specified by Treasury) to discount the amount of unpaid losses. In addition, the special rule that extends the loss payment pattern period for long-tail lines of business would be applied

similarly to all lines of business (but with the 5-year limitation on the extended period increased to 15 years), so that (1) in general, the amount of losses that would have been treated as paid in the third year after the accident year would be treated as paid in the third year and in each subsequent year in an amount equal to the average of the amount of the losses treated as paid in the first and second years after the accident year, and (2) in the case of lines of business relating to auto or other liability, medical malpractice, workers' compensation, multiple peril lines, international coverage, and reinsurance, the amount of losses which would have been treated as paid in the tenth year after the accident year would be treated as paid in the tenth year and in each subsequent year in an amount equal to the average of the amount of the losses treated as paid in the seventh, eighth, and ninth years after the accident year. The provision also would repeal the election to use company-specific, rather than industry-wide, historical loss payment patterns. The provision generally would be effective for tax years beginning after 2017, with a transition rule that would spread adjustments relating to pre-effective date losses and expenses over such tax year and the succeeding seven tax years.

**Considerations:**

- Replacing the mid-term applicable Federal rate with the corporate bond yield would result in a more accurate measurement of income for P&C insurance companies.
- In addition, generally applying the rules for determining the loss payment pattern period that currently only apply to long-tail lines of business would provide consistent treatment for all lines of insurance business.

**JCT estimate:** According to JCT, the provision would increase revenues by \$13.2 billion over 2018-2027.

**Sec. 3709. Repeal of special estimated tax payments.**

**Current law:** Under current law, insurance companies may elect to claim a deduction equal to the difference between the amount of reserves computed on a discounted basis and the amount computed on an undiscounted basis. Companies that make this election are required to make a special estimated tax payment equal to the tax benefit attributable to the deduction. In addition, the deductions are added to a special loss discount account and, as losses are paid in future years, amounts are subtracted from the account and made subject to tax (net of prior special estimated tax payments). Amounts added to the special loss discount account are automatically subtracted from the account and made subject to tax if they have not already been subtracted after 15 years.

**Provision:** Under the provision, the elective deduction and related special estimated tax payment rules would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by less than \$50 million over 2018-2027.

### **Sec. 3710. Capitalization of certain policy acquisition expenses.**

**Current law:** Under current law, the expenses of a life insurance company that are associated with earning a stream of premium income generally are required to be spread over ten years rather than deducted immediately, to reflect the fact that such income ordinarily is collected over a period of years. The expenses that are spread are calculated using a simplified method that reflects expense ratios for three broad categories of insurance contracts. The expenses that must be spread are the lesser of: (1) a specified percentage of the net premiums received on each of a company's three categories of insurance contracts; or (2) the company's general deductions. For annuity contracts, the specified percentage is 1.75 percent; for group life insurance contracts, it is 2.05 percent; and for all other specified insurance contracts, it is 7.7 percent.

**Provision:** Under the provision, the categories of insurance contracts and the percentages of expenses to be spread would be updated to reflect current expense ratios for insurance products. The three categories of insurance contracts would be replaced with two categories: (1) group contracts covering a group of connected individuals, such as by employment or membership in an organization; and (2) all other specified contracts. The percentage of net premiums that would be spread over ten years would be 4 percent for group insurance contracts and 11 percent for all other specified contracts. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$7.0 billion over 2018-2027.

## **Subtitle I – Compensation**

### **Sec. 3801. Nonqualified deferred compensation.**

**Current law:** Under current law, compensation generally is taxable to an employee and deductible by an employer in the year earned, with two significant exceptions. First, for compensation provided as part of a qualified defined benefit or defined contribution pension plan, the employee does not take such compensation into income until the year in which a distribution from the plan occurs, while the employer generally may take the deduction in the year the compensation is earned. Second, for non-qualified deferred compensation, the employee does not take such compensation into income until the year received, but the employer's deduction is postponed until that time. The employee generally must take non-qualified deferred compensation into income, however, if the compensation is put into a trust protected from the employer's creditors in bankruptcy as soon as there is no substantial risk of forfeiture with regard to the compensation. In addition, if the employer is located in a jurisdiction in which the employer is not effectively subject to income tax (*i.e.*, certain foreign jurisdictions), the compensation is immediately taxable as soon as it is not subject to a substantial risk of forfeiture. Other rules apply to deferred compensation paid by a State or local government or tax-exempt organization, in which case an employee may defer tax so long as the deferred compensation is less than the limit on employee contributions for 401(k) plans (*i.e.*, \$18,000 for 2017).

**Provision:** Under the provision, an employee would be taxed on compensation as soon as there is no substantial risk of forfeiture with regard to that compensation (*i.e.*, receipt of the compensation is not subject to future performance of substantial services). A condition shall not be treated as constituting a substantial risk of forfeiture solely because it consists of a covenant not to compete or because the condition relates (nominally or otherwise) to a purpose of the compensation other than the future performance of services – regardless of whether such condition is intended to advance a purpose of the compensation or is solely intended to defer taxation of the compensation.

The provision would be effective for amounts attributable to services performed after 2017. The current-law rules would continue to apply to existing non-qualified deferred compensation arrangements until the last tax year beginning before 2026, when such arrangements would become subject to the provision.

**Considerations:**

- The provision repeals a current-law tax benefit for which only highly compensated employees are generally eligible.
- The provision creates simplicity in an area of taxation that is extremely complex under current law.

**JCT estimate:** According to JCT, the provision would increase revenues by \$16.2 billion over 2018-2027.

**Sec. 3802. 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.

**Provision:** Under the provision, the exceptions to the \$1 million deduction limitation for commissions and performance-based compensation would be repealed. The provision also would revise the definition of “covered employee” to include the CEO, the chief financial officer, and the three other highest paid employees, realigning the definition with current SEC

disclosure rules. Under the modified definition, once an employee qualifies as a covered person, the deduction limitation would apply for Federal tax purposes to that person so long as the corporation pays remuneration to such person (or to any beneficiaries). The provision would be effective for tax years beginning after 2017.

**Considerations:**

- The significant exceptions to the current limit on the deductible executive compensation by publicly traded corporations have resulted in a shift away from cash compensation paid to senior executives in favor of stock options and other forms of performance pay.
- This shift has led to perverse consequences as some executives focus on – and could, in rare cases, manipulate – quarterly results (off of which their compensation is determined), rather than on the long-term success of the company.

**JCT estimate:** According to JCT, the provision would increase revenues by \$9.3 billion over 2018-2027.

**Sec. 3803. Excise tax on excess tax-exempt organization executive compensation.**

**Current law:** Under current law, the deduction allowed to publicly traded C corporations for compensation paid with respect to chief executive officers and certain highly paid officers is limited to no more than \$1 million per year. Similarly, current law limits the deductibility of certain severance-pay arrangements (“parachute payments”). No parallel limitation applies to tax-exempt organizations with respect to executive compensation and severance payments.

**Provision:** Under the provision, a tax-exempt organization would be subject to a 20-percent excise tax on compensation in excess of \$1 million paid to any of its five highest paid employees for the tax year. The excise tax would apply to all remuneration paid to a covered person for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than cash, except for payments to a tax-qualified retirement plan, and amounts that are excludable from the executive’s gross income.

Once an employee qualifies as a covered person, the excise tax would apply to compensation in excess of \$1 million paid to that person so long as the organization pays him remuneration. The excise tax also would apply to excess parachute payments paid by the organization to such individuals. Under the provision, an excess parachute payment generally would be a payment contingent on the employee’s separation from employment with an aggregate present value of three times the employee’s base compensation or more. The provision would be effective for tax years beginning after 2017.

**Considerations:**

- Current law generally has no limit on excessive compensation paid by a tax-exempt organization to its senior management other than the limitation on private inurement, the consequence of which can be revocation of the organization’s exemption.
- Tax-exempt organizations enjoy a tax subsidy from the Federal government as a result of the requirement that they use their resources for specific purposes. Some may question

whether excessive executive compensation diverts resources from those particular purposes.

- The provision is consistent with the limitation on the deductibility of executive compensation by taxable publicly traded corporations.
- Given that exemption from Federal income tax constitutes a significant benefit conferred upon tax-exempt organizations, the case for discouraging excess compensation paid out to such organizations' executives may be even stronger than it is for publicly traded companies.

**JCT estimate:** According to JCT, the provision would increase revenues by \$3.6 billion over 2018-2027.



## **Title IV – Taxation of Foreign Income and Foreign Persons**

### **Subtitle A – Establishment of Participation Exemption System for Taxation of Foreign Income**

#### **Sec. 4001. Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations.**

**Current law:** Under current law, U.S. citizens, resident individuals, and domestic corporations generally are taxed on all income, whether earned in the United States or abroad. Foreign income earned by a foreign subsidiary of a U.S. corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. corporation. To mitigate the double taxation on earnings of the foreign corporation, the United States allows a credit for foreign income taxes paid. The foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign income. When foreign tax credits are insufficient to offset the U.S. tax liability on the foreign subsidiary’s earnings, the additional U.S. tax the U.S. corporation must pay upon receiving those earnings is referred to as the “U.S. residual tax.” A U.S. taxpayer may elect to deduct foreign income taxes paid rather than claim the credit.

**Provision:** Under the provision, the current-law system of taxing U.S. corporations on the foreign earnings of their foreign subsidiaries when these earnings are distributed would be replaced with a dividend-exemption system. Under the exemption system, 100 percent of the foreign-source portion of dividends paid by a foreign corporation to a U.S. corporate shareholder that owns 10 percent or more of the foreign corporation would be exempt from U.S. taxation. No foreign tax credit or deduction would be allowed for any foreign taxes (including withholding taxes) paid or accrued with respect to any exempt dividend, and no deductions for expenses properly allocable to an exempt dividend (or stock that gives rise to exempt dividends) would be taken into account for purposes of determining the U.S. corporate shareholder’s foreign-source income. The provision would be effective for distributions made after 2017.

#### **Considerations:**

- The provision would allow U.S. companies to compete on a more level playing field against foreign multinationals when selling products and services abroad by eliminating an additional level of tax that their competitors do not face.
- The provision would eliminate the “lock-out” effect under current law, which encourages U.S. companies to avoid bringing their foreign earnings back into the United States so that they can avoid the U.S. residual tax on those earnings.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$205.1 billion over 2018-2027.

### **Sec. 4002. Application of participation exemption to investments in United States property.**

**Current law:** Under current law, a U.S. corporate shareholder of a foreign subsidiary generally is not subject to U.S. tax on the earnings of the foreign subsidiary until the earnings are distributed to the U.S. parent corporation. The foreign subsidiary's undistributed earnings that are reinvested in United States property are subject to current U.S. tax. For this purpose, United States property generally includes tangible property located in the United States, intangible property used in the United States, and equity and debt interests in U.S. affiliates. As a result, a U.S. corporate shareholder cannot avoid U.S. tax on the distribution of earnings from a foreign subsidiary by instead reinvesting those earnings in United States property.

**Provision:** Under the provision, the imposition of current U.S. tax on U.S. corporate shareholders with respect to untaxed foreign subsidiary earnings reinvested in United States property would be repealed. The provision would be effective for tax years of foreign corporations beginning after 2017.

#### **Considerations:**

- The provision would remove disincentives for investment of foreign earnings in the United States.
- Under section 4001 of the bill, a 100 percent exemption would be provided for the foreign-source portion of dividends from the foreign subsidiary of a U.S. corporate shareholder. As a result, no U.S. tax would be avoided by a U.S. parent corporation reinvesting earnings of its foreign subsidiary in United States property rather than distributing those earnings.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$2.0 billion over 2018-2027.

### **Sec. 4003. Limitation on losses with respect to specified 10-percent owned foreign corporations.**

**Current law:** Under current law, any gain that is recognized by a U.S. parent corporation on the sale or exchange of its stock in a foreign subsidiary generally is treated as a dividend distribution by the foreign subsidiary to its U.S. parent to the extent of earnings and profits (E&P) that have been accumulated by the foreign subsidiary while it had been owned by the U.S. parent. Any gain in excess of that typically is capital gain to the U.S. parent.

In some cases, U.S. companies may operate businesses in foreign countries through a branch rather than through a separate, foreign subsidiary. In these situations, U.S. companies pay U.S. taxes on the foreign earnings or deduct losses on a current basis, as if earned directly by the U.S. parent.

**Provision:** Under the provision, a U.S. parent would reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividends received by the U.S. parent from its foreign

subsidiary – but only for purposes of determining the amount of a loss (but not the amount of any gain) on any sale or exchange of the foreign subsidiary stock by its U.S. parent. The provision would be effective for distributions made after 2017.

In addition, if a U.S. corporation transfers substantially all of the assets of a foreign branch to a foreign subsidiary, the U.S. corporation would be required to include in income the amount of any post-2017 losses that were incurred by the branch. The provision would be effective for transfers after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$11.1 billion over 2018-2027.

#### **Sec. 4004. Treatment of deferred foreign income upon transition to participation exemption system of taxation.**

**Current law:** Under current law, U.S. citizens, resident individuals, and domestic corporations generally are taxed on all income, whether earned in the United States or abroad. Foreign income earned by a foreign subsidiary that is owned by a U.S. shareholder generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. shareholder. To mitigate the double taxation on earnings of the foreign corporation, the United States allows either a credit or a deduction for foreign income taxes paid. The foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign income

**Provision:** Under the provision, U.S. shareholders owning at least 10 percent of a foreign subsidiary, generally, would include in income for the subsidiary's last tax year beginning before 2018 the shareholder's pro rata share of the net post-1986 historical earnings and profits (E&P) of the foreign subsidiary to the extent such E&P has not been previously subject to U.S. tax, determined as of November 2, 2017, or December 31, 2017 (whichever is higher). The net E&P would be determined by taking into account the U.S. shareholder's proportionate share of any E&P deficits of foreign subsidiaries of the U.S. shareholder or members of the U.S. shareholder's affiliated group.

The E&P would be classified as either E&P that has been retained in the form of cash or cash equivalents, or E&P that has been reinvested in the foreign subsidiary's business (*e.g.* property, plant, and equipment). The portion of the E&P comprising cash or cash equivalents would be taxed at a reduced rate of 12 percent, while any remaining E&P would be taxed at a reduced rate of 5 percent. Foreign tax credit carryforwards would be fully available, and foreign tax credits triggered by the deemed repatriation would be partially available, to offset the U.S. tax.

At the election of the U.S. shareholder, the tax liability would be payable over a period of up to 8 years, in equal annual installments of 12.5 percent of the total tax liability due.

If the U.S. shareholder is an S corporation, the provision would not apply until the S corporation ceases to be an S corporation, substantially all of the assets of the S corporation are sold or

liquidated, the S corporation ceases to exist or conduct business, or stock in the S corporation is transferred.

**Considerations:**

- The provision would generally eliminate the need for U.S. companies to separately track E&P that was accumulated by their foreign subsidiaries prior to adoption of the dividend-exemption system, so that all distributions from foreign subsidiaries would be treated in the same manner under the dividend-exemption system.
- Deeming unrepatriated foreign earnings to be repatriated would eliminate the tax advantage to keep these earnings off-shore.
- The provision would moderate the tax burden on illiquid accumulated E&P that has been reinvested in the foreign subsidiary's business.
- The tax resulting from the provision would be payable over time, to allow taxpayers time to compute their liability and repatriate funds to pay it.

**JCT estimate:** According to JCT, the provision would increase revenues by \$223.1 billion over 2018-2027.

## **Subtitle B – Modifications Related to Foreign Tax Credit System**

### **Sec. 4101. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis.**

**Current law:** Under current law, foreign income earned by a foreign subsidiary of a U.S. corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. parent corporation. To mitigate the double taxation on earnings of the foreign corporation, the United States allows a credit or a deduction for foreign income taxes paid, but generally only when the foreign earnings are distributed to the U.S. parent or otherwise subject to U.S. taxation. The foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income.

Under certain circumstances, the U.S. parent corporation is subject to U.S. tax on certain foreign income of its foreign subsidiaries (“subpart F income”) even if the income is not repatriated. A U.S. parent corporation generally may claim a credit for foreign taxes paid on the subpart F income.

**Provision:** Under the provision, no foreign tax credit or deduction would be allowed for any taxes (including withholding taxes) paid or accrued with respect to any dividend to which the dividend exemption under section 4001 of the bill would apply. A foreign tax credit would be allowed for any subpart F income that is included in the income of the U.S. shareholder on a current year basis, without regard to pools of foreign earnings kept abroad. The provision would be effective for tax years of foreign corporations beginning after 2017 and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** The revenue effect of the provision over 2018-2027 is included in the JCT estimate provided for section 4004 of the bill.

**Sec. 4102. Source of income from sales of inventory determined solely on basis of production activities.**

**Current law:** Under current law, in determining the source of income for foreign tax credit purposes, up to 50 percent of the income from the sale of inventory property that is produced within the United States and sold outside the United States (or vice versa) may be treated as foreign-source income, even though the production activity takes place entirely within the United States.

**Provision:** Under the provision, income from the sale of inventory property produced within and sold outside the United States (or vice versa) would be allocated and apportioned between sources within and outside the United States solely on the basis of the production activities with respect to the inventory. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.5 billion over 2018-2027.

**Subtitle C – Modifications of Subpart F Provisions**

**Sec. 4201. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment.**

**Current law:** Foreign shipping income earned between 1976 and 1986 was not subject to current U.S. tax under subpart F if the income was reinvested in certain qualified shipping investments. Under current law, such income becomes subject to current U.S. tax in a subsequent year to the extent that there is a net decrease in qualified shipping investments during that subsequent year.

**Provision:** Under the provision, the imposition of current U.S. tax on previously excluded foreign shipping income of a foreign subsidiary if there is a net decrease in qualified shipping investments would be repealed. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** According to JCT, the provision would reduce revenues by less than \$50 million over 2018-2027.

**Sec. 4202. Repeal of treatment of foreign base company oil related income as subpart F income.**

**Current law:** Under current law, a U.S. parent of a foreign subsidiary is subject to current U.S. tax under subpart F on certain foreign oil related income (“foreign base company oil related income”), regardless of whether the foreign subsidiary distributes such income to the U.S. parent.

**Provision:** Under the provision, the imposition of current U.S. tax on foreign base company oil related income would be repealed. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$3.9 billion over 2018-2027.

**Sec. 4203. Inflation adjustment of de minimis exception for foreign base company income.**

**Current law:** Under current law, a U.S. parent of a foreign subsidiary is subject to current U.S. tax on its pro rata share of the subsidiary’s subpart F income, regardless of whether the income is distributed to the U.S. parent. However, a de minimis rule states that if the gross amount of such income is less than the lesser of 5 percent of the foreign subsidiary’s gross income or \$1 million, then the U.S. parent is not subject to current U.S. tax on any of the income. The \$1 million threshold is not adjusted for inflation.

**Provision:** Under the provision, the \$1 million threshold would be adjusted for inflation. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$0.4 billion over 2018-2027.

**Sec. 4204. Look-thru rule for related controlled foreign corporations made permanent.**

**Current law:** Under current law, a U.S. parent of a foreign subsidiary generally is subject to current U.S. tax on dividends, interest, royalties, rents, and other types of passive income earned by the foreign subsidiary, regardless of whether the foreign subsidiary distributes such income to the U.S. parent. However, for tax years of foreign subsidiaries beginning before 2020, and tax years of U.S. shareholders in which or with which such tax years of the foreign subsidiary end, a special “look-through” rule provides that passive income received by one foreign subsidiary from a related foreign subsidiary generally is not includible in the taxable income of the U.S. parent, provided such income was not subject to current U.S. tax or effectively connected with a U.S. trade or business.

**Provision:** Under the provision, the look-through rule would be made permanent. The provision would be effective for tax years of foreign corporations beginning after 2019, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$11.8 billion over 2018-2027.

**Sec. 4205. Modification of stock attribution rules for determining status as a controlled foreign corporation.**

**Current law:** Under current law, a U.S. parent of a certain foreign subsidiary called a controlled foreign corporations (CFC) is subject to current U.S. tax on its pro rata share of the CFC's subpart F income, regardless of whether the income is distributed to the U.S. parent. A foreign subsidiary is a CFC if it is more than 50 percent owned by one or more U.S. persons, each of which owns at least 10 percent of the foreign subsidiary. For these purposes, a U.S. person may be treated as constructively owning stock held by certain related persons, affiliates, and shareholders, but a U.S. corporation generally cannot be treated as constructively owning stock held by its foreign shareholder.

**Provision:** Under the provision, a U.S. corporation would be treated as constructively owning stock held by its foreign shareholder. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** The revenue effect of the provision over 2018-2027 is included in the JCT estimate provided for section 4001 of the bill.

**Sec. 4206. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply.**

**Current law:** Under current law, a U.S. parent of a CFC is subject to current U.S. tax on its pro rata share of the CFC's subpart F income, but only if the U.S. parent owns stock in the foreign subsidiary for an uninterrupted period of 30 days or more during the year.

**Provision:** Under the provision, a U.S. parent would be subject to current U.S. tax on the CFC's subpart F income even if the U.S. parent does not own stock in the CFC for an uninterrupted period of 30 days or more during the year. The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.4 billion over 2018-2027.

## Subtitle D – Prevention of Base Erosion

### Sec. 4301. Current year inclusion by United States shareholders with foreign high returns.

**Current law:** Under current law, a U.S. parent of a foreign subsidiary is subject to current U.S. tax on its pro rata share of the subsidiary's subpart F income, regardless of whether the income is distributed to the U.S. parent. In addition, foreign income earned by the U.S. parent directly is subject to U.S. tax upon receipt of the income. Under current transfer pricing rules, however, if a foreign subsidiary of the U.S. parent owns important assets, undertakes key functions, or bears significant risks in a foreign jurisdiction, that foreign subsidiary is treated as earning more than a routine profit, often resulting in substantial profits being generated at the foreign subsidiary level. Allocating profits in this manner does not trigger taxation under the subpart F rules; thus, U.S. tax on those profits is deferred until they are distributed to the U.S. parent.

**Provision:** Under the provision, a U.S. parent of one or more foreign subsidiaries would be subject to current U.S. tax on fifty percent of the U.S. parent's foreign high returns. Foreign high returns would be measured as the excess of the U.S. parent's foreign subsidiaries' aggregate net income over a routine return (7 percent plus the Federal short-term rate) on the foreign subsidiaries' aggregate adjusted bases in depreciable tangible property, adjusted downward for interest expense. Foreign high returns would not include income effectively connected with a U.S. trade or business, subpart F income, insurance and financing income that meets the requirements for the active finance exemption (AFE) from subpart F income under current law, income from the disposition of commodities produced or extracted by the taxpayer, or certain related-party payments. Like subpart F income, the U.S. parent would be taxed on foreign high returns each year, regardless of whether it left those earnings offshore or repatriated the earnings to the United States.

Foreign high returns would be treated similarly to currently-taxed subpart F income for certain purposes of the Code, including for purposes of allowing a foreign tax credit. The foreign tax credits allowed for foreign taxes paid with respect to foreign high returns would be limited to 80 percent of the foreign taxes paid, would not be allowed against U.S. tax imposed on other foreign-source income (*i.e.*, such foreign tax credits would only be allowed to offset U.S. tax on foreign high return inclusions), and would not be allowed to be carried back or forward to other tax years.

The provision would be effective for tax years of foreign corporations beginning after 2017, and for tax years of U.S. shareholders in which or with which such tax years of foreign subsidiaries end.

#### **Considerations:**

- Under current law, the allocation of income by U.S. companies to intangible property and risks that are located in low-tax or no-tax jurisdictions (through migration out of the United States or otherwise) is an acute source of erosion of the U.S. tax base.



- The adoption of a dividend-exemption system could, on its own and without appropriate safeguards, exacerbate this incentive by allowing profits that have been shifted to be repatriated with minimal U.S. tax consequences.
- The provision would remove this incentive by currently taxing foreign high returns frequently attributable to intangible property and risks.
- At the same time, the provision would provide a reduced U.S. tax rate on such income in recognition that it is difficult to identify precisely when the allocation of income to intangible property and risks in foreign jurisdictions results in erosion of the U.S. tax base.

**JCT estimate:** According to JCT, the provision would increase revenues by \$77.1 billion over 2018-2027.

**Sec. 4302. Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group.**

**Current law:** Under current law, corporations generally may deduct all of their interest expense. If the proceeds of the debt are used to capitalize a foreign subsidiary, the earnings from those proceeds generally will not be subject to U.S. tax until distributed as a dividend. Therefore, U.S. corporations can achieve a net U.S. tax benefit by deducting the interest expense currently while deferring the U.S. taxation of the corresponding earnings generated by the debt proceeds. Additionally, irrespective of the use of the proceeds of the debt, if the debt is issued to a foreign affiliate, the corresponding interest income generally is subject to a statutory 30-percent withholding tax. Income tax treaties between the United States and other countries, however, often reduce or eliminate this withholding tax. Consequently, U.S. corporations can erode the U.S. tax base by deducting interest paid on related-party debt (even when the amount of interest expense is legitimately arm's length) without paying U.S. tax on the corresponding income.

**Provision:** Under the provision, the deductible net interest expense of a U.S. corporation that is a member of an international financial reporting group would be limited to the extent the U.S. corporation's share of the group's global net interest expense exceeds 110 percent of the U.S. corporation's share of the group's global earnings before interest, taxes, depreciation, and amortization (EBITDA). This limitation would apply in addition to the general rules for disallowance of certain interest expense under section 3301 of the bill. Taxpayers would be disallowed interest deductions pursuant to whichever provision denies a greater amount of interest deductions. Any disallowed interest expense would be carried forward for up to five tax years, with carryforwards exhausted on a first in, first out basis. For this purpose, an international financial reporting group is a group of entities that includes at least one foreign corporation engaged in a trade or business in the United States or at least one domestic corporation and one foreign corporation, prepares consolidated financial statements, and has annual global gross receipts of more than \$100 million. The provision would be effective for tax years beginning after 2017.

**Considerations:**

- While reducing the corporate tax rate would reduce the incentive for U.S. companies to maintain excessive leverage, it is important to provide measures to discourage excessive leverage directly in conjunction with the adoption of a dividend-exemption system.
- The provision would prevent multinational companies from generating excessive interest deductions in the United States on debt that is issued to foreign affiliates or that is incurred to produce exempt foreign income in a dividend-exemption system.
- The provision would apply equally to foreign and U.S. companies in order to provide a level playing field.
- The provision recognizes standard non-tax business practices that involve parent corporations incurring debt to finance the acquisition or establishment of subsidiaries by (1) allowing the U.S. group to have 10 percent more leverage than the worldwide group, and (2) providing a five-year carryforward of disallowed interest expense.

**JCT estimate:** According to JCT, the provision would increase revenues by \$34.2 billion over 2018-2027.

**Sec. 4303. Excise tax on certain payments from domestic corporations to related foreign corporations; election to treat such payments as effectively connected income.**

**Current law:** Under current law, foreign corporations generally are subject to U.S. tax only on U.S.-source fixed or determinable annual or periodical (FDAP) income and income effectively connected with the conduct of a U.S. trade or business (known as effective connected income, or ECI). Income tax treaties between the United States and other countries often reduce or eliminate U.S. tax imposed on FDAP income. Additionally, a foreign corporation typically will not be treated as conducting a U.S. trade or business where it does not own property, employ individuals, or direct agents located in the United States. Multinational enterprises, and particularly foreign-parented multinational enterprises, can erode the U.S. tax base by shifting profits to foreign affiliates, as current transfer pricing rules allow the attribution of profit to risks, assets, and functions outside of the United States. Unlike U.S. companies, the foreign profits of foreign affiliates will generally never be subject to U.S. tax. This gives foreign companies a significant tax advantage over U.S. companies for sales to U.S. customers and provides significant tax incentives for U.S. companies to either invert or be acquired by foreign companies.

**Provision:** Under the provision, payments (other than interest) made by a U.S. corporation to a related foreign corporation that are deductible, includible in costs of goods sold, or includible in the basis of a depreciable or amortizable asset would be subject to a 20 percent excise tax, unless the related foreign corporation elected to treat the payments as income effectively connected with the conduct of a U.S. trade or business. Consequently, the foreign corporation's net profits (or gross receipts if no election is made) with respect to those payments would be subject to full U.S. tax, eliminating the potential U.S. tax benefit otherwise achieved. Exceptions would apply for intercompany services which a U.S. company elects to pay for at cost (*i.e.*, no markup) and certain commodities transactions. To determine the net taxable income that is to be deemed ECI, the foreign corporation's deductions attributable to these payments would be determined by

reference to the profit margins reported on the group's consolidated financial statements for the relevant product line. No credit would be allowed for foreign taxes paid with respect to the profits subject to U.S. tax. Further, in the event no election is made, no deduction would be allowed for the U.S. corporation's excise tax liability.

The provision would apply only to international financial reporting groups with payments from U.S. corporations to their foreign affiliates totaling at least \$100 million annually. The provision would be effective for tax years beginning after 2018.

### **Considerations:**

- Current law affords significant opportunities to multinational companies to erode the U.S. tax base through deductible related-party payments. Although these payments frequently relate to globalized supply chains and other legitimate business operations, the tax benefit achieved by reducing U.S. taxable income without a corresponding increase in U.S. taxable income elsewhere in the multinational group results in a distorted computation of the overall U.S. tax liability of multinational companies.
- Additionally, this aspect of current law incentivizes and subsidizes the shift of American jobs overseas because additional functions performed abroad allow for greater deductible payments from U.S. corporations to their foreign affiliates.
- Current anti-base erosion rules, as well as section 4211 of the bill, focus only on U.S. companies' foreign subsidiaries and, therefore, fail to address the full scope of U.S. tax base erosion. Consequently, U.S. companies are at a competitive disadvantage relative to their foreign peers – who are not subject to other base erosion provisions in the Code – with regard to competing for U.S. and foreign customers.
- The provision would eliminate the U.S. tax benefit afforded to multinational companies that make deductible payments between U.S. and foreign affiliates by imposing full U.S. tax on those profits irrespective of where they are booked.
- At the taxpayer's election, the provision would allow a deduction for third-party expenses, computed under objective formulas.
- The provision would apply equally to foreign and U.S. companies in order to provide a level playing field.
- The provision would reaffirm the arm's length principle by reinforcing the significance of accurately pricing related-party transactions to avoid subjecting amounts that are in excess of arm's-length prices to U.S. taxation.

**JCT estimate:** According to JCT, the provision would increase revenues by \$154.5 billion over 2018-2027.

## **Subtitle E – Provisions Related to Possessions of the United States**

### **Sec. 4401. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico.**

**Current law:** Under current law, taxpayers may claim a deduction equal to 9 percent (6 percent in the case of certain oil and gas activities) of the lesser of the taxpayer's qualified production

activities income or the taxpayer's taxable income for the tax year. The deduction is limited to 50 percent of the W-2 wages paid by the taxpayer during the calendar year. Qualified production activities income is equal to domestic production gross receipts less the cost of goods sold and expenses properly allocable to such receipts. Qualifying receipts are derived from property that was manufactured, produced, grown, or extracted within the United States; qualified film productions; production of electricity, natural gas, or potable water; construction activities performed in the United States; and certain engineering or architectural services. Qualifying receipts do not include gross receipts derived from the sale of food or beverages prepared at a retail establishment; the transmission or distribution of electricity, gas, and potable water; or the disposition of land. In general, the term "United States" includes Puerto Rico for this purpose for tax years beginning before January 1, 2017.

**Provision:** Under the provision, eligibility of domestic gross receipts from Puerto Rico for the domestic production deduction would apply retroactively to tax years beginning after December 31, 2016 and before January 1, 2018.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$0.1 billion over 2018-2027.

#### **Sec. 4402. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands.**

**Current law:** Under current law, a \$13.50 per proof gallon excise tax is imposed on distilled spirits produced in or imported into the United States, unless exported from the United States (including exported to U.S. possessions). A portion of tax amounts attributable to shipments to the United States of rum produced in Puerto Rico or the U.S. Virgin Islands are covered over (paid) to Puerto Rico or the U.S. Virgin Islands, respectively. The portion is \$13.25 per proof gallon for imports before 2017, and \$10.50 per proof gallon for other imports.

**Provision:** Under the provision, the \$13.25 per proof gallon excise tax cover-over amount paid to the treasuries of Puerto Rico and the U.S. Virgin Islands would apply retroactively to include imports after December 31, 2016, and be extended to rum imported into the United States before January 1, 2023.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$0.8 billion over 2018-2027.

#### **Sec. 4403. Extension of American Samoa economic development credit.**

**Current law:** Under current law, a domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before 2006 is allowed a credit based on the corporation's economic activity-based limitation with respect to American Samoa. The credit is not part of the Code but

is computed based on the rules of sections 30A and 936. The credit is allowed for the first eleven tax years of a corporation that begin after 2005 and before 2017.

**Provision:** Under the provision, the credit for taxpayers currently operating in American Samoa would retroactively apply to tax years beginning after December 31, 2016, and be extended to tax years beginning before January 1, 2023.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$0.1 billion over 2018-2027.

## **Subtitle F – Other International Reforms**

### **Sec. 4501. Restriction on insurance business exception to passive foreign investment company rules.**

**Current law:** Under current law, U.S. shareholders of a passive foreign investment company (PFIC) are 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.

**Provision:** 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 is solely due to temporary circumstances). The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.1 billion over 2018-2027.

### **Sec. 4502 – Limitation on treaty benefits for certain deductible payments**

**Current law:** Under current law, certain payments of fixed or determinable, annual or periodical (FDAP) income – such as interest, dividends, rents, and annuities – to foreign recipients are subject to a statutory 30-percent withholding tax. Income tax treaties between the United States and other countries, however, often reduce or eliminate this withholding tax for payments from one treaty country to residents of the other treaty country.

**Provision:** Under the provision, if a payment of FDAP income is deductible in the United States and the payment is made by an entity that is controlled by a foreign parent to another entity in a

tax treaty jurisdiction that is controlled by the same foreign parent, then the statutory 30-percent withholding tax on such income would not be reduced by any treaty unless the withholding tax would be reduced by a treaty if the payment were made directly to the foreign parent. The provision would be effective for payments made after the date of enactment.

**JCT estimate:** According to JCT, the provision would increase revenues by \$7.6 billion over 2018-2027.

## Title V – Exempt Organizations

### Considerations for Title V:

- Tax-exempt entities such as charities, foundations, and other non-profit organizations provide needed assistance and support to millions of families and communities nationwide. Some Tax Code provisions for tax-exempt entities are out of date and require updating to truly reflect the necessities of tax-exempt entities in today’s environment.
- The net investment excise tax on private foundations has long been a source of confusion and frustration for taxpayers. Private foundations, both large and small, recommended to the Committee’s Tax Reform Working Group on Charitable/Exempt Organizations that the net investment tax be reduced to a lower rate in order to ease compliance. The bill adopts this recommendation to ease the administrative burden on foundations and encourage more funding of charitable activities.
- Endowments at many private colleges are large enough that parity requires that they be placed on equal footing with private foundations when it comes to paying a tax on net-investment income.

### Subtitle A – Unrelated Business Income Tax

#### **Sec. 5001. Clarification of unrelated business income tax treatment of entities treated as exempt from taxation under section 501(a).**

**Current law:** Under current law, income derived from a trade or business regularly carried on by an organization exempt from tax under Code section 501(a) (including pension plans) that is not substantially related to the performance of the organization’s tax-exempt functions is subject to the unrelated business income tax (“UBIT”). The highest corporate rate is applied to unrelated business income. A college or university that is an agency or instrumentality of a State government (or political subdivision) generally is subject to UBIT on any unrelated business taxable income. It is unclear, however, whether certain State and local entities (such as public pension plans) that are exempt under Code section 115(l) as government-sponsored entities as well as section 501(a) are subject to the UBIT rules.

**Provision:** Under the provision, all entities exempt from tax under section 501(a), notwithstanding the entity’s exemption under any other provision of the Code, would be subject to the UBIT rules. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$1.1 billion over 2018-2027.

#### **Sec. 5002. Exclusion of research income limited to publicly available research.**

**Current law:** Under current law, income derived from a research trade or business is exempt from UBIT in the following cases: (1) research performed for the United States (including

agencies and instrumentalities) or any State (or political subdivision); (2) research performed by a college, university or hospital for any person; and (3) research performed by an organization operated primarily for the purposes of carrying on fundamental research the results of which are freely available to the general public.

**Provision:** Under the provision, the organization may exclude from UBTI only income from such fundamental research the results of which are freely made available to the public. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.7 billion over 2018-2027.

## **Subtitle B – Excise Taxes**

### **Sec. 5101. Simplification of excise tax on private foundation investment income.**

**Current law:** Under current law, private foundations are subject to a 2-percent excise tax on their net investment incomes. However, they may reduce this excise tax rate to 1 percent by making distributions equal to the averages of their distributions from the previous five years plus 1 percent.

**Provision:** Under the provision, the excise tax rate on net investment income would be streamlined to a single rate of 1.4 percent. Additionally, the rules providing for a reduction in the excise tax rate from 2 percent to 1 percent would be repealed. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$0.5 billion over 2018-2027.

### **Sec. 5102. Private operating foundation requirements relating to operation of art museum.**

**Current law:** Under current law, private operating foundations, which are a form of private foundation that may use tax-free donations to fund their own activities rather than make grants to other charities, are exempt from a 30-percent excise tax on certain undistributed earnings that other private foundations must pay.

**Provision:** Under the provision, an art museum claiming the status of a private operating foundation would not be recognized as such unless it is open to the public for at least 1,000 hours per year. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by less than \$50 million over 2018-2027.



### **Sec. 5103. Excise tax based on investment income of private colleges and universities.**

**Current law:** Under current law, private foundations and certain charitable trusts are subject to an excise tax of up to 2 percent on their net investment income. (Section 5101 would reduce this excise tax to 1.4 percent.) The excise tax on net investment income does not apply to public charities, including colleges and universities, even though some such organizations may have substantial investment income similar to private foundations.

**Provision:** Under the provision, certain private colleges and universities would be subject to a 1.4 percent excise tax on net investment income. The provision would only apply to private colleges and universities that have at least 500 students and assets (other than those used directly in carrying out the institution's educational purposes) valued at the close of the preceding tax year of at least \$100,000 per full-time student. State colleges and universities would not be subject to the provision. The provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by \$3.0 billion over 2018-2027.

### **Sec. 5104. Exception from private foundation excess business holding tax for independently-operated philanthropic business holdings.**

**Current law:** Under current law, a private foundation may not own more than a 20-percent interest in a for-profit business, and any private foundation that does hold more than such an excess holding is subject to a 10-percent excise tax based on the value of that excess holding. Any private foundation that does not divest itself of such excess holding by the close of the subsequent year is subject to a 200-percent excise tax based on the value of that excess holding.

**Provision:** Under the provision, private foundations would be exempt from this excess-business-holdings tax if they own a for-profit business under these conditions: (1) the foundation owns all of the for-profit business' voting stock, (2) the private foundation acquired all of its interests in the for-profit business other than by purchasing it, (3) the for-profit business distributes all of its net operating income for any given tax year to the private foundation within 120 days of the close of that tax year, and (4) the for-profit business' directors and executives are not substantial contributors to the private foundation nor make up a majority of the private foundation's board of directors. This provision would be effective for tax years beginning after 2017.

**JCT estimate:** According to JCT, the provision would increase revenues by less than \$50 million over 2018-2027.

## **Subtitle C – Requirements for Organizations Exempt From Tax**

### **Sec. 5201. Churches are permitted to make statements relating to political campaign in ordinary course of religious services and activities.**

**Current law:** Under current law, an entity exempt from tax under Code section 501(c)(3) is prohibited from “participating in, or intervening in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”

**Provision:** Under the provision, this language, known as the Johnson amendment, is qualified so that entities described under section 508(c)(1)(A) would not fail to be treated as organized and operated exclusively for a religious purpose, assuming the speech is in the ordinary course of the organization’s business and its expenses are de minimus. This provision would be effective for tax years ending after date of enactment.

**JCT estimate:** According to JCT, the provision would reduce revenues by \$2.1 billion over 2018-2027.

### **Sec. 5202. Additional reporting requirements for donor advised fund sponsoring organizations.**

**Current law:** Under current law, public charities (including community foundations) exempt from tax under Code section 501(c)(3) are permitted to establish accounts to which donors may contribute and thereafter provide nonbinding advice or recommendations with regard to distributions from the fund or the investment of assets in the fund. Such accounts are commonly referred to as “donor advised funds.” Donors who make contributions to charities sponsoring such funds generally may claim a charitable-contribution deduction at the time of the contribution, even though the contributed funds may be held in the account without distribution for significant periods. While the sponsoring charities generally must have legal ownership and control over the funds held in a donor advised fund, there is no requirement that the funds be distributed to other charitable organizations within any period of time. Donor advised funds also are not subject to the private foundation net investment excise tax.

**Provision:** Under the provision, donor advised funds would be required to disclose annually their policies on inactive donor advised funds as well as the average amount of grants made from their donor advised funds.

**JCT estimate:** According to JCT, the provision would have no revenue effect over 2018-2027.