115TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
115–409

TAX CUTS AND JOBS ACT

R E P O R T

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ON

H.R. 1

together with

DISSENTING AND ADDITIONAL VIEWS

[Including cost estimate of the Congressional Budget Office]

NOVEMBER 13, 2017.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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TAX CUTS AND JOBS ACT

NOVEMBER 13, 2017.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. BRADY of Texas, from the Committee on Ways and Means, submitted the following

R E P O R T

together with

DISSENTING AND ADDITIONAL VIEWS

[To accompany H.R. 1]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 1) to provide for reconciliation pursuant to title II of the concurrent resolution on the budget for fiscal year 2018, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Tax Cuts and Jobs Act".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents for this Act is as follows:

TITLE I—TAX REFORM FOR INDIVIDUALS

Subtitle A—Simplification and Reform of Rates, Standard Deduction, and Exemptions

SEC. 1001. REDUCTION AND SIMPLIFICATION OF INDIVIDUAL INCOME TAX RATES.

(a) IN GENERAL.—Section 1 is amended by striking subsection (i) and by striking all that precedes subsection (h) and inserting the following:

"SEC. 1. TAX IMPOSED.

"(a) IN GENERAL.—There is hereby imposed on the income of every individual a tax equal to the sum of—

"(1) 12 PERCENT BRACKET.—12 percent of so much of the taxable income as does not exceed the 25-percent bracket threshold amount,

"(2) 25 PERCENT BRACKET.—25 percent of so much of the taxable income as exceeds the 25-percent bracket threshold amount but does not exceed the 35-percent bracket threshold amount, plus

"(3) 35 PERCENT BRACKET.—35 percent of so much of taxable income as exceeds the 35-percent bracket threshold amount but does not exceed the 39.6 percent bracket threshold amount.

"(4) 39.6 PERCENT BRACKET.—39.6 percent of so much of taxable income as exceeds the 39.6-percent bracket threshold amount.

"(b) BRACKET THRESHOLD AMOUNTS.—For purposes of this section—

"(1) 25-PERCENT BRACKET THRESHOLD AMOUNT.—The term '25-percent bracket threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $90,000,

"(B) in the case of an individual who is the head of a household (as defined in section 2(b)), $67,500,

"(C) in the case of any other individual (other than an estate or trust), an amount equal to ½ of the amount in effect for the taxable year under subparagraph (A), and

"(D) in the case of an estate or trust, $2,550.

"(2) 35-PERCENT BRACKET THRESHOLD AMOUNT.—The term '35-percent bracket threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $260,000,

"(B) in the case of a married individual filing a separate return, an amount equal to ½ of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual (other than an estate or trust), $200,000, and

"(D) in the case of an estate or trust, $9,150.

"(3) 39.6-PERCENT BRACKET THRESHOLD AMOUNT.—The term '39.6-percent bracket threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $1,000,000,

"(B) in the case of any other individual (other than an estate or trust), an amount equal to ½ of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of an estate or trust, $12,500.

"(c) INFLATION ADJUSTMENT.—

"(1) IN GENERAL.—In the case of any taxable year beginning after 2018, each dollar amount in subsections (b) and (e)(3) (other than any amount determined by reference to such a dollar amount) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under this subsection for the calendar year in which the taxable year begins by substituting '2017' for '2016' in paragraph (2)(A)(ii).

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.

"(2) COST-OF-LIVING ADJUSTMENT.—For purposes of this subsection—

"(A) IN GENERAL.—The cost-of-living adjustment for any calendar year is the percentage (if any) by which—

"(i) the C-CPI-U for the preceding calendar year, exceeds

"(ii) the normalized CPI for calendar year 2016.

"(B) SPECIAL RULE FOR ADJUSTMENTS WITH A BASE YEAR AFTER 2016.—For purposes of any provision which provides for the substitution of a year after 2016 for '2016' in subparagraph (A)(ii), subparagraph (A) shall be applied by substituting 'C-CPI-U' for 'normalized CPI' in clause (ii).

"(3) NORMALIZED CPI.—For purposes of this subsection, the normalized CPI for any calendar year is the product of—

"(A) the CPI for such calendar year, multiplied by

"(B) the C-CPI-U transition multiple.

"(4) C-CPI-U TRANSITION MULTIPLE.—For purposes of this subsection, the term 'C-CPI-U transition multiple' means the amount obtained by dividing—

"(A) the C-CPI-U for calendar year 2016, by

"(B) the CPI for calendar year 2016.

"(5) C-CPI-U.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'C-CPI-U' means the Chained Consumer Price Index for All Urban Consumers (as published by the Bureau of Labor Statistics of the Department of Labor). The values of the Chained Consumer Price Index for All Urban Consumers taken into account for purposes of determining the cost-of-living adjustment for any calendar year under this subsection shall be the latest values so published as of the date on which such Bureau publishes the initial value of the Chained Consumer Price Index for All Urban Consumers for the month of August for the preceding calendar year.

"(B) DETERMINATION FOR CALENDAR YEAR.—The C-CPI-U for any calendar year is the average of the C-CPI-U as of the close of the 12-month period ending on August 31 of such calendar year.

"(6) CPI.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'Consumer Price Index' means the last Consumer Price Index for All Urban Consumers published by the Department of Labor. For purposes of the preceding sentence, the revision of the Consumer Price Index which is most consistent with the Consumer Price Index for calendar year 1986 shall be used.

"(B) DETERMINATION FOR CALENDAR YEAR.—The CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on August 31 of such calendar year.

"(d) SPECIAL RULES FOR CERTAIN CHILDREN WITH UNEARNED INCOME.—

"(1) IN GENERAL.—In the case of any child to whom this subsection applies for any taxable year—

"(A) the 25-percent bracket threshold amount shall not be more than the taxable income of such child for the taxable year reduced by the net unearned income of such child, and

"(B) the 35-percent bracket threshold amount shall not be more than the sum of—

"(i) the taxable income of such child for the taxable year reduced by the net unearned income of such child, plus

"(ii) the dollar amount in effect under subsection (b)(2)(D) for the taxable year.

"(C) the 39.6-percent bracket threshold amount shall not be more than the sum of—

"(i) the taxable income of such child for the taxable year reduced by the net unearned income of such child, plus

"(ii) the dollar amount in effect under subsection (b)(3)(C).

"(2) CHILD TO WHOM SUBSECTION APPLIES.—This subsection shall apply to any child for any taxable year if—

"(A) such child—

"(i) has not attained age 18 before the close of the taxable year, or

"(ii) has attained age 18 before the close of the taxable year and is described in paragraph (3),

"(B) either parent of such child is alive at the close of the taxable year, and

"(C) such child does not file a joint return for the taxable year.

"(3) CERTAIN CHILDREN WHOSE EARNED INCOME DOES NOT EXCEED ONE-HALF OF INDIVIDUAL'S SUPPORT.—A child is described in this paragraph if—

"(A) such child—

"(i) has not attained age 19 before the close of the taxable year, or

"(ii) is a student (within the meaning of section 7706(f)(2)) who has not attained age 24 before the close of the taxable year, and

"(B) such child's earned income (as defined in section 911(d)(2)) for such taxable year does not exceed one-half of the amount of the individual's support (within the meaning of section 7706(c)(1)(D) after the application of section 7706(f)(5) (without regard to subparagraph (A) thereof)) for such taxable year.

"(4) NET UNEARNED INCOME.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'net unearned income' means the excess of—

"(i) the portion of the adjusted gross income for the taxable year which is not attributable to earned income (as defined in section 911(d)(2)), over

"(ii) the sum of—

"(I) the amount in effect for the taxable year under section 63(c)(2)(A) (relating to limitation on standard deduction in the case of certain dependents), plus

"(II) The greater of the amount described in subclause (I) or, if the child itemizes his deductions for the taxable year, the amount of the itemized deductions allowed by this chapter for the taxable year which are directly connected with the production of the portion of adjusted gross income referred to in clause (i).

"(B) LIMITATION BASED ON TAXABLE INCOME.—The amount of the net unearned income for any taxable year shall not exceed the individual's taxable income for such taxable year.

"(e) PHASEOUT OF 12-PERCENT RATE.—

"(1) IN GENERAL.—The amount of tax imposed by this section (determined without regard to this subsection) shall be increased by 6 percent of the excess (if any) of—

"(A) adjusted gross income, over

"(B) the applicable dollar amount.

"(2) LIMITATION.—The increase determined under paragraph (1) with respect to any taxpayer for any taxable year shall not exceed 27.6 percent of the lesser of—

"(A) the taxpayer's taxable income for such taxable year, or

"(B) the 25-percent bracket threshold amount in effect with respect to the taxpayer for such taxable year.

"(3) APPLICABLE DOLLAR AMOUNT.—For purposes of this subsection, the term 'applicable dollar amount' means—

"(A) in the case of a joint return or a surviving spouse, $1,200,000,

"(B) in the case of a married individual filing a separate return, an amount equal to ½ of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual, $1,000,000.

"(4) ESTATES AND TRUSTS.—Paragraph (1) shall not apply in the case of an estate or trust.".

(b) APPLICATION OF CURRENT INCOME TAX BRACKETS TO CAPITAL GAINS BRACKETS.—

(1) IN GENERAL.—

(A) 0-PERCENT CAPITAL GAINS BRACKET.—Section 1(h)(1) is amended by striking "which would (without regard to this paragraph) be taxed at a rate below 25 percent" in subparagraph (B)(i) and inserting "below the 15-percent rate threshold".

(B) 15-PERCENT CAPITAL GAINS BRACKET.—Section 1(h)(1)(C)(ii)(I) is amended by striking "which would (without regard to this paragraph) be taxed at a rate below 39.6 percent" and inserting "below the 20-percent rate threshold".

(2) RATE THRESHOLDS DEFINED.—Section 1(h) is amended by adding at the end the following new paragraph:

"(12) RATE THRESHOLDS DEFINED.—For purposes of this subsection—

"(A) 15-PERCENT RATE THRESHOLD.—The 15-percent rate threshold shall be—

"(i) in the case of a joint return or surviving spouse, $77,200 (½ such amount in the case of a married individual filing a separate return),

"(ii) in the case of an individual who is the head of a household (as defined in section 2(b)), $51,700, "(iii) in the case of any other individual (other than an estate or trust), an amount equal to ½ of the amount in effect for the taxable year under clause (i), and

"(iv) in the case of an estate or trust, $2,600.

"(B) 20-PERCENT RATE THRESHOLD.—The 20-percent rate threshold shall be—

"(i) in the case of a joint return or surviving spouse, $479,000 (½ such amount in the case of a married individual filing a separate return),

"(ii) in the case of an individual who is the head of a household (as defined in section 2(b)), $452,400,

"(iii) in the case of any other individual (other than an estate or trust), $425,800, and

"(iv) in the case of an estate or trust, $12,700.

"(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, each of the dollar amounts in subparagraphs (A) and (B) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under subsection (c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.".

(c) APPLICATION OF SECTION 15.—

(1) IN GENERAL.—Subsection (a) of section 15 is amended by striking "by this chapter" and inserting "by section 11 (or by reference to any such rates)".

(2) CONFORMING AMENDMENTS.—

(A) Section 15 is amended by striking subsections (d) and (f) and by redesignating subsection (e) as subsection (d).

(B) Section 15(d), as redesignated by subparagraph (A), is amended by striking "section 1 or 11(b)" and inserting "section 11(b)".

(C) Section 6013(c) is amended by striking "sections 15, 443, and 7851(a)(1)(A)" and inserting "sections 443 and 7851(a)(1)(A)".

(3) APPLICATION TO THIS ACT.—Section 15 of the Internal Revenue Code of 1986 shall not apply to any change in a rate of tax imposed by chapter 1 of such Code which occurs by reason of any amendment made by this Act (other than the amendments made by section 3001).

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) SUBSECTION (c).—The amendments made by subsection (c) shall take effect on the date of the enactment of this Act.

SEC. 1002. ENHANCEMENT OF STANDARD DEDUCTION.

(a) INCREASE IN STANDARD DEDUCTION.—Section 63(c) is amended to read as follows:

"(c) STANDARD DEDUCTION.—For purposes of this subtitle—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'standard deduction' means—

"(A) $24,400, in the case of a joint return (or a surviving spouse (as defined in section 2(a)),

"(B) three-quarters of the amount in effect under subparagraph (A) for the taxable year, in the case of the head of a household (as defined in section 2(b)), and

"(C) one-half of the amount in effect under subparagraph (A) for the taxable year, in any other case.

"(2) LIMITATION ON STANDARD DEDUCTION IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual who is a dependent of another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the standard deduction applicable to such individual for such individual's taxable year shall not exceed the greater of—

"(A) $500, or

"(B) the sum of $250 and such individual's earned income (within the means of section 32).

"(3) CERTAIN INDIVIDUALS, ETC., NOT ELIGIBLE FOR STANDARD DEDUCTION.—In the case of—

"(A) a married individual filing a separate return where either spouse itemizes deductions,

"(B) a nonresident alien individual,

"(C) an individual making a return under section 443(a)(1) for a period of less than 12 months on account of a change in his annual accounting period, or

"(D) an estate or trust, common trust fund, or partnership,

the standard deduction shall be zero.

"(4) UNMARRIED INDIVIDUAL.—For purposes of this section, the term 'unmarried individual' means any individual who—

"(A) is not married as of the close of the taxable year (as determined by applying section 7703),

"(B) is not a surviving spouse (as defined in section 2(a)) for the taxable year, and

"(C) is not a dependent of another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins.

"(5) INFLATION ADJUSTMENTS.—

"(A) STANDARD DEDUCTION AMOUNT.—In the case of any taxable year beginning after 2019, the dollar amount in paragraph (1)(A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2018' for 'calendar year 2016' in clause (ii) thereof.

"(B) LIMITATION AMOUNT IN CASE OF CERTAIN DEPENDENTS.—In the case of any taxable year beginning after 2017, each of the dollar amounts in paragraph (2) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii)(I) in the case of the dollar amount in paragraph (2)(A), under section 1(c)(2)(A) for the calendar year in which the taxable year begins determined by substituting 'calendar year 1987' for 'calendar year 2016' in clause (ii) thereof, and

"(II) in the case of the dollar amount in paragraph (2)(B), under section 1(c)(2)(A) for the calendar year in which the taxable year begins determined by substituting 'calendar year 1997' for 'calendar year 2016' in clause (ii) thereof.

If any increase determined under this paragraph is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.".

(b) CONFORMING AMENDMENTS.—

(1) Section 63(b) is amended by striking ", minus—" and all that follows and inserting "minus the standard deduction".

(2) Section 63 is amended by striking subsections (f) and (g).

(3) Section 1398(c) is amended—

(A) by striking "BASIC" in the heading thereof,

(B) by striking "BASIC STANDARD" in the heading of paragraph (3) and inserting "STANDARD", and

(C) by striking "basic" in paragraph (3).

(4) Section 3402(m)(3) is amended by striking "(including the additional standard deduction under section 63(c)(3) for the aged and blind)".

(5) Section 6014(b)(4) is amended by striking "section 63(c)(5)" and inserting "section 63(c)(2)".

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1003. REPEAL OF DEDUCTION FOR PERSONAL EXEMPTIONS.

(a) IN GENERAL.—Part V of subchapter B of chapter 1 is hereby repealed.

(b) DEFINITION OF DEPENDENT RETAINED.—Section 152, prior to repeal by subsection (a), is hereby redesignated as section 7706 and moved to the end of chapter 79.

(c) APPLICATION TO ESTATES AND TRUSTS.—Subsection (b) of section 642 is amended—

(1) by striking paragraph (2)(C),

(2) by striking paragraph (3), and

(3) by striking "DEDUCTION FOR PERSONAL EXEMPTION" in the heading thereof and inserting "BASIC DEDUCTION".

(d) APPLICATION TO NONRESIDENT ALIENS.—Section 873(b) is amended by striking paragraph (3).

(e) MODIFICATION OF WAGE WITHHOLDING RULES.—

(1) IN GENERAL.—Section 3402(a) is amended by striking paragraph (2).

(2) CONFORMING AMENDMENT.—Section 3402(a) is amended—

(A) by redesignating subparagraphs (A) and (B) of paragraph (1) as paragraphs (1) and (2) and moving such redesignated paragraphs 2 ems to the left, and

(B) by striking all that precedes "otherwise provided in this section" and inserting the following:

"(a) REQUIREMENT OF WITHHOLDING.—Except as".

(3) NUMBER OF EXEMPTIONS.—Section 3402(f)(1) is amended—

(A) in subparagraph (A), by striking "an individual described in section 151(d)(2)" and inserting "a dependent of any other taxpayer", and

(B) in subparagraph (C), by striking "with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 151(c)" and inserting "who, on the basis of facts existing at the beginning of such day, is reasonably expected to be a dependent of the employee".

(f) MODIFICATION OF RETURN REQUIREMENT.—

(1) IN GENERAL.—Paragraph (1) of section 6012(a) is amended to read as follows:

"(1) Every individual who has gross income for the taxable year, except that a return shall not be required of—

"(A) an individual who is not married (determined by applying section 7703) and who has gross income for the taxable year which does not exceed the standard deduction applicable to such individual for such taxable year under section 63, or

"(B) an individual entitled to make a joint return if—

"(i) the gross income of such individual, when combined with the gross income of such individual's spouse, for the taxable year does not exceed the standard deduction which would be applicable to the taxpayer for such taxable year under section 63 if such individual and such individual's spouse made a joint return,

"(ii) such individual and such individual's spouse have the same household as their home at the close of the taxable year,

"(iii) such individual's spouse does not make a separate return, and

"(iv) neither such individual nor such individual's spouse is an individual described in section 63(c)(2) who has income (other than earned income) in excess of the amount in effect under section 63(c)(2)(A).".

(2) BANKRUPTCY ESTATES.—Paragraph (8) of section 6012(a) is amended by striking "the sum of the exemption amount plus the basic standard deduction under section 63(c)(2)(D)" and inserting "the standard deduction in effect under section 63(c)(1)(B)".

(g) CONFORMING AMENDMENTS.—

(1) Section 2(a)(1)(B) is amended by striking "a dependent" and all that follows through "section 151" and inserting "a dependent who (within the meaning of section 7706, determined without regard to subsections (b)(1), (b)(2) and (d)(1)(B) thereof) is a son, stepson, daughter, or stepdaughter of the taxpayer".

(2) Section 36B(b)(2)(A) is amended by striking "section 152" and inserting "section 7706".

(3) Section 36B(b)(3)(B) is amended by striking "unless a deduction is allowed under section 151 for the taxable year with respect to a dependent" in the flush matter at the end and inserting "unless the taxpayer has a dependent for the taxable year".

(4) Section 36B(c)(1)(D) is amended by striking "with respect to whom a deduction under section 151 is allowable to another taxpayer" and inserting "who is a dependent of another taxpayer".

(5) Section 36B(d)(1) is amended by striking "equal to the number of individuals for whom the taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year" and inserting "the sum of 1 (2 in the case of a joint return) plus the number of the taxpayer's dependents for the taxable year".

(6) Section 36B(e)(1) is amended by striking "1 or more individuals for whom a taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year (including the taxpayer or his spouse)" and inserting "1 or more of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer".

(7) Section 42(i)(3)(D)(ii)(I) is amended—

(A) by striking "section 152" and inserting "section 7706", and

(B) by striking the period at the end and inserting a comma.

(8) Section 72(t)(2)(D)(i)(III) is amended by striking "section 152" and inserting "section 7706".

(9) Section 72(t)(7)(A)(iii) is amended by striking "section 152(f)(1)" and inserting "section 7706(f)(1)".

(10) Section 105(b) is amended—

(A) by striking "as defined in section 152" and inserting "as defined in section 7706",

(B) by striking "section 152(f)(1)" and inserting "section 7706(f)(1)" and

(C) by striking "section 152(e)" and inserting "section 7706(e)".

(11) Section 105(c)(1) is amended by striking "section 152" and inserting "section 7706".

(12) Section 125(e)(1)(D) is amended by striking "section 152" and inserting "section 7706".

(13) Section 132(h)(2)(B) is amended—

(A) by striking "section 152(f)(1)" and inserting "section 7706(f)(1)", and

(B) by striking "section 152(e)" and inserting "section 7706(e)".

(14) Section 139D(c)(5) is amended by striking "section 152" and inserting "section 7706".

(15) Section 162(l)(1)(D) is amended by striking "section 152(f)(1)" and inserting "section 7706(f)(1)".

(16) Section 170(g)(1) is amended by striking "section 152" and inserting "section 7706".

(17) Section 170(g)(3) is amended by striking "section 152(d)(2)" and inserting "section 7706(d)(2)".

(18) Section 172(d) is amended by striking paragraph (3).

(19) Section 220(b)(6) is amended by striking "with respect to whom a deduction under section 151 is allowable to" and inserting "who is a dependent of".

(20) Section 220(d)(2)(A) is amended by striking "section 152" and inserting "section 7706".

(21) Section 223(b)(6) is amended by striking "with respect to whom a deduction under section 151 is allowable to" and inserting "who is a dependent of".

(22) Section 223(d)(2)(A) is amended by striking "section 152" and inserting "section 7706".

(23) Section 401(h) is amended by striking "section 152(f)(1)" in the last sentence and inserting "section 7706(f)(1)".

(24) Section 402(l)(4)(D) is amended by striking "section 152" and inserting "section 7706".

(25) Section 409A(a)(2)(B)(ii)(I) is amended by striking "section 152(a)" and inserting "section 7706(a)".

(26) Section 501(c)(9) is amended by striking "section 152(f)(1)" and inserting "section 7706(f)(1)".

(27) Section 529(e)(2)(B) is amended by striking "section 152(d)(2)" and inserting "section 7706(d)(2)".

(28) Section 703(a)(2) is amended by striking subparagraph (A) and by redesignating subparagraphs (B) through (F) as subparagraphs (A) through (E), respectively.

(29) Section 874 is amended by striking subsection (b) and by redesignating subsection (c) as subsection (b).

(30) Section 891 is amended by striking "under section 151 and".

(31) Section 904(b) is amended by striking paragraph (1).

(32) Section 931(b)(1) is amended by striking "(other than the deduction under section 151, relating to personal exemptions)".

(33) Section 933 is amended—

(A) by striking "(other than the deduction under section 151, relating to personal exemptions)" in paragraph (1), and

(B) by striking "(other than the deduction for personal exemptions under section 151)" in paragraph (2).

(34) Section 1212(b)(2)(B)(ii) is amended to read as follows:

"(ii) in the case of an estate or trust, the deduction allowed for such year under section 642(b).".

(35) Section 1361(c)(1)(C) is amended by striking "section 152(f)(1)(C)" and inserting "section 7706(f)(1)(C)".

(36) Section 1402(a) is amended by striking paragraph (7).

(37) Section 2032A(c)(7)(D) is amended by striking "section 152(f)(2)" and inserting "section 7706(f)(2)".

(38) Section 3402(m)(1) is amended by striking "other than the deductions referred to in section 151 and".

(39) Section 3402(r)(2) is amended by striking "the sum of—" and all that follows and inserting "the standard deduction in effect under section 63(c)(1)(B).".

(40) Section 5000A(b)(3)(A) is amended by striking "section 152" and inserting "section 7706".

(41) Section 5000A(c)(4)(A) is amended by striking "the number of individuals for whom the taxpayer is allowed a deduction under section 151 (relating to allowance of deduction for personal exemptions) for the taxable year" and inserting "the sum of 1 (2 in the case of a joint return) plus the number of the taxpayer's dependents for the taxable year".

(42) Section 6013(b)(3)(A) is amended—

(A) by striking "had less than the exemption amount of gross income" in clause (ii) and inserting "had no gross income",

(B) by striking "had gross income of the exemption amount or more" in clause (iii) and inserting "had any gross income", and

(C) by striking the flush language following clause (iii).

(43) Section 6103(l)(21)(A)(iii) is amended to read as follows:

"(iii) the number of the taxpayer's dependents,".

(44) Section 6213(g)(2) is amended by striking subparagraph (H).

(45) Section 6334(d)(2) is amended to read as follows:

"(2) EXEMPT AMOUNT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'exempt amount' means an amount equal to—

"(i) the standard deduction, divided by

"(ii) 52.

"(B) VERIFIED STATEMENT.—Unless the taxpayer submits to the Secretary a written and properly verified statement specifying the facts necessary to determine the proper amount under subparagraph (A), subparagraph (A) shall be applied as if the taxpayer were a married individual filing a separate return with no dependents.".

(46) Section 7702B(f)(2)(C)(iii) is amended by striking "section 152(d)(2)" and inserting "section 7706(d)(2)".

(47) Section 7703(a) is amended by striking "part V of subchapter B of chapter 1 and".

(48) Section 7703(b)(1) is amended by striking "section 152(f)(1)" and all that follows and inserting "section 7706(f)(1),".

(49) Section 7706(a), as redesignated by this section, is amended by striking "this subtitle" and inserting "subtitle A".

(50)(A) Section 7706(d)(1)(B), as redesignated by this section, is amended by striking "the exemption amount (as defined in section 151(d))" and inserting "$4,150".

(B) Section 7706(d), as redesignated by this section, is amended by adding at the end the following new paragraph:

"(6) INFLATION ADJUSTMENT.—In the case of any calendar year beginning after 2018, the $4,150 amount in paragraph (1)(B) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.".

(51) The table of sections for chapter 79 is amended by adding at the end the following new item:

"Sec. 7706. Dependent defined.".

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1004. MAXIMUM RATE ON BUSINESS INCOME OF INDIVIDUALS.

(a) IN GENERAL.—Part I of subchapter A of chapter 1 is amended by inserting after section 3 the following new section:

"SEC. 4. 25 PERCENT MAXIMUM RATE ON BUSINESS INCOME OF INDIVIDUALS.

"(a) REDUCTION IN TAX TO ACHIEVE 25 PERCENT MAXIMUM RATE.—The tax imposed by section 1 shall be reduced by the sum of—

"(1) 10 percent of the lesser of—

"(A) qualified business income, or

"(B) the excess (if any) of—

"(i) taxable income reduced by net capital gain (as defined in section 1(h)(11)(A)), over

"(ii) the maximum dollar amount for the 25-percent rate bracket which applies to the taxpayer under section 1 for the taxable year, and

"(2) 4.6 percent of the excess (if any) of—

"(A) the lesser of—

"(i) qualified business income, or

"(ii) the excess (if any) determined under paragraph (1)(B), over

"(B) the excess of—

"(i) the maximum dollar amount for the 35-percent rate bracket which applies to the taxpayer under section 1 for the taxable year, over

"(ii) the maximum dollar amount for the 25-percent rate bracket which applies to the taxpayer under section 1 for the taxable year.

"(b) QUALIFIED BUSINESS INCOME.—For purposes of this section, the term 'qualified business income' means the excess (if any) of—

"(1) the sum of—

"(A) 100 percent of any net business income derived from any passive business activity, plus

"(B) the capital percentage of any net business income derived from any active business activity, over

"(2) the sum of—

"(A) 100 percent of any net business loss derived from any passive business activity,

"(B) except as provided in subsection (e)(3)(A), 30 percent of any net business loss derived from any active business activity, plus

"(C) any carryover business loss determined for the preceding taxable year.

"(c) DETERMINATION OF NET BUSINESS INCOME OR LOSS.—For purposes of this section—

"(1) IN GENERAL.—Net business income or loss shall be determined with respect to any business activity by appropriately netting items of income, gain, deduction, and loss with respect to such business activity.

"(2) WAGES, ETC.—Any wages (as defined in section 3401), payments described in subsection (a) or (c) of section 707, or directors' fees received by the taxpayer which are properly attributable to any business activity shall be taken into account under paragraph (1) as an item of income with respect to such business activity.

"(3) EXCEPTION FOR CERTAIN INVESTMENT-RELATED ITEMS.—There shall not be taken into account under paragraph (1)—

"(A) any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss,

"(B) any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G),

"(C) any interest income other than interest income which is properly allocable to a trade or business,

"(D) any item of gain or loss described in subparagraph (C) or (D) of section 954(c)(1) (applied by substituting 'business activity' for 'controlled foreign corporation'),

"(E) any item of income, gain, deduction, or loss taken into account under section 954(c)(1)(F) (determined without regard to clause (ii) thereof and other than items attributable to notional principal contracts entered into in transactions qualifying under section 1221(a)(7)),

"(F) any amount received from an annuity which is not received in connection with the trade or business of the business activity, and

"(G) any item of deduction or loss properly allocable to an amount described in any of the preceding subparagraphs.

"(4) APPLICATION OF RESTRICTIONS APPLICABLE TO DETERMINING TAXABLE INCOME.—Net business income or loss shall be appropriately adjusted so as only to take into account any amount of income, gain, deduction, or loss to the extent such amount affects the determination of taxable income for the taxable year.

"(5) CARRYOVER BUSINESS LOSS.—For purposes of subsection (b)(2)(C), the carryover business loss determined for any taxable year is the excess (if any) of the sum described in subsection (b)(2) over the sum described in subsection (b)(1) for such taxable year.

"(d) PASSIVE AND ACTIVE BUSINESS ACTIVITY.—For purposes of this section—

"(1) PASSIVE BUSINESS ACTIVITY.—The term 'passive business activity' means any passive activity as defined in section 469(c) determined without regard to paragraphs (3) and (6)(B) thereof.

"(2) ACTIVE BUSINESS ACTIVITY.—The term 'active business activity' means any business activity which is not a passive business activity.

"(3) BUSINESS ACTIVITY.—The term 'business activity' means any activity (within the meaning of section 469) which involves the conduct of any trade or business.

"(e) CAPITAL PERCENTAGE.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this section, the term 'capital percentage' means 30 percent.

"(2) INCREASED PERCENTAGE FOR CAPITAL-INTENSIVE BUSINESS ACTIVITIES.—In the case of a taxpayer who elects the application of this paragraph with respect to any active business activity (other than a specified service activity), the capital percentage shall be equal to the applicable percentage (as defined in subsection (f)) for each taxable year with respect to which such election applies. Any election made under this paragraph shall apply to the taxable year for which such election is made and each of the 4 subsequent taxable years. Such election shall be made not later than the due date (including extensions) for the return of tax for the taxable year for which such election is made, and, once made, may not be revoked.

"(3) TREATMENT OF SPECIFIED SERVICE ACTIVITIES.—

"(A) IN GENERAL.—In the case of any active business activity which is a specified service activity—

"(i) the capital percentage shall be 0 percent, and

"(ii) subsection (b)(2)(B) shall be applied by substituting '0 percent' for '30 percent'.

"(B) EXCEPTION FOR CAPITAL-INTENSIVE SPECIFIED SERVICE ACTIVITIES.—If—

"(i) the taxpayer elects the application of this subparagraph with respect to such activity for any taxable year, and

"(ii) the applicable percentage (as defined in subsection (f)) with respect to such activity for such taxable year is at least 10 percent,

then subparagraph (A) shall not apply and the capital percentage with respect to such activity shall be equal to such applicable percentage.

"(C) SPECIFIED SERVICE ACTIVITY.—The term 'specified service activity' means any activity involving the performance of services described in section 1202(e)(3)(A), including investing, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

"(4) REDUCTION IN CAPITAL PERCENTAGE IN CERTAIN CASES.—The capital percentage (determined after the application of paragraphs (2) and (3)) with respect to any active business activity shall not exceed 1 minus the quotient (not greater than 1) of—

"(A) any amounts described in subsection (c)(2) which are taken into account in determining the net business income derived from such activity, divided by

"(B) such net business income.

"(f) APPLICABLE PERCENTAGE.—For purposes of this section—

"(1) IN GENERAL.—The term 'applicable percentage' means, with respect to any active business activity for any taxable year, the quotient (not greater than 1) of—

"(A) the specified return on capital with respect to such activity for such taxable year, divided by

"(B) the taxpayer's net business income derived from such activity for such taxable year.

"(2) SPECIFIED RETURN ON CAPITAL.—The term 'specified return on capital' means, with respect to any active business activity referred to in paragraph (1), the excess of—

"(A) the product of—

"(i) the deemed rate of return for the taxable year, multiplied by

"(ii) the asset balance with respect to such activity for such taxable year, over

"(B) an amount equal to the interest which is paid or accrued, and for which a deduction is allowed under this chapter, with respect to such activity for such taxable year.

"(3) DEEMED RATE OF RETURN.—The term 'deemed rate of return' means, with respect to any taxable year, the Federal short-term rate (determined under section 1274(d) for the month in which or with which such taxable year ends) plus 7 percentage points.

"(4) ASSET BALANCE.—

"(A) IN GENERAL.—The asset balance with respect to any active business activity referred to in paragraph (1) for any taxable year equals the taxpayer's adjusted basis of any property described in section 1221(a)(2) which is used in connection with such activity as of the end of the taxable year (determined without regard to sections 168(k) and 179).

"(B) APPLICATION TO ACTIVITIES CARRIED ON THROUGH PARTNERSHIPS AND S CORPORATIONS.—In the case of any active business activity carried on through a partnership or S corporation, the taxpayer shall take into account such taxpayer's distributive or pro rata share (as the case may be) of the asset balance with respect to such activity as determined with respect to such partnership or S corporation under subparagraph (A) (applied by substituting 'the partnership's or S corporation's adjusted basis' for 'the taxpayer's adjusted basis').

"(g) REDUCED RATE FOR SMALL BUSINESSES WITH NET ACTIVE BUSINESS INCOME.—

"(1) IN GENERAL.—The tax imposed by section 1 shall be reduced by 3 percent of the excess (if any) of—

"(A) the least of—

"(i) qualified active business income,

"(ii) taxable income reduced by net capital gain (as defined in section 1(h)(11)(A)), or

"(iii) the 9-percent bracket threshold amount, over

"(B) the excess (if any) of taxable income over the applicable threshold amount.

"(2) PHASE-IN OF RATE REDUCTION.—In the case of any taxable year beginning before January 1, 2022, paragraph (1) shall be applied by substituting for '3 percent'—

"(A) in the case of any taxable year beginning after December 31, 2017, and before January 1, 2020, '1 percent', and

"(B) in the case of any taxable year beginning after December 31, 2019, and before January 1, 2022, '2 percent'.

"(3) QUALIFIED ACTIVE BUSINESS INCOME.—For purposes of this subsection, the term 'qualified active business income' means the excess (if any) of—

"(A) any net business income derived from any active business activity, over

"(B) any net business loss derived from any active business activity.

"(4) 9-PERCENT BRACKET THRESHOLD AMOUNT.—For purposes of this subsection, the term '9-percent bracket threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $75,000,

"(B) in the case of an individual who is the head of a household (as defined in section 2(b)), ¾ of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual, ½ of the amount in effect for the taxable year under subparagraph (A).

"(5) APPLICABLE THRESHOLD AMOUNT.—For purposes of this subsection, the term 'applicable threshold amount' means—

"(A) in the case of a joint return or surviving spouse, $150,000,

"(B) in the case of an individual who is the head of a household (as defined in section 2(b)), ¾ of the amount in effect for the taxable year under subparagraph (A), and

"(C) in the case of any other individual, ½ of the amount in effect for the taxable year under subparagraph (A).

"(6) ESTATES AND TRUSTS.—Paragraph (1) shall not apply to any estate or trust.

"(7) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, the dollar amounts in paragraphs (4)(A) and (5)(A) shall each be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under subsection (c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.

"(h) REGULATIONS.—The Secretary may issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this section, including regulations or other guidance—

"(1) which ensures that no amount is taken into account under subsection (f)(4) with respect to more than one activity, and

"(2) which treats all specified service activities of the taxpayer as a single business activity for purposes of this section to the extent that such activities would be treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414.

"(i) REFERENCES.—Any reference in this title to section 1 shall be treated as including a reference to this section unless the context of such reference clearly indicates otherwise.".

(b) 25 PERCENT RATE FOR CERTAIN DIVIDENDS OF REAL ESTATE INVESTMENT TRUSTS AND COOPERATIVES.—Section 1(h), as amended by the preceding provisions of this Act, is amended by adding at the end the following new paragraph:

"(13) 25 PERCENT RATE FOR CERTAIN DIVIDENDS OF REAL ESTATE INVESTMENT TRUSTS AND COOPERATIVES.—

"(A) IN GENERAL.—For purposes of this subsection, net capital gain (as defined in paragraph (11)) and unrecaptured section 1250 gain (as defined in paragraph (6)) shall each be increased by specified dividend income.

"(B) SPECIFIED DIVIDEND INCOME.—For purposes of this paragraph, the term 'specified dividend income' means—

"(i) in the case of any dividend received from a real estate investment trust, the portion of such dividend which is neither—

"(I) a capital gain dividend (as defined in section 852(b)(3)), nor

"(II) taken into account in determining qualified dividend income (as defined in paragraph (11)), and

"(ii) any dividend which is includible in gross income and which is received from an organization or corporation described in section 501(c)(12) or 1381(a).".

(c) CLERICAL AMENDMENT.—The table of sections for part I of subchapter A of chapter 1 is amended by inserting after the item relating to section 3 the following new item:

"Sec. 4. 25 percent maximum rate on business income of individuals.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(e) TRANSITION RULE.—In the case of any taxable year which includes December 31, 2017, the amendment made by subsection (a) shall apply with respect to such taxable year adjusted—

(1) so as to apply with respect to the rates of tax in effect under section 1 of the Internal Revenue Code of 1986 with respect to such taxable year (and so as to achieve a 25 percent effective rate of tax on the business income (determined without regard to paragraph (2)) in the same manner as such amendment applies to taxable years beginning after such date with respect to the rates of tax in effect for such years), and

(2) by reducing the amount of the reduction in tax (as otherwise determined under paragraph (1)) by the amount which bears the same proportion to the amount of such reduction as the number of days in the taxable year which are before January 1, 2018, bears to the number of days in the entire taxable year.

SEC. 1005. CONFORMING AMENDMENTS RELATED TO SIMPLIFICATION OF INDIVIDUAL INCOME TAX RATES.

(a) AMENDMENTS RELATED TO MODIFICATION OF INFLATION ADJUSTMENT.—

(1) Section 32(b)(2)(B)(ii)(II) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins determined by substituting 'calendar year 2008' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins determined by substituting 'calendar year 2008' for 'calendar year 2016' in clause (ii) thereof".

(2) Section 32(j)(1)(B) is amended—

(A) in the matter preceding clause (i), by striking "section 1(f)(3)" and inserting "section 1(c)(2)(A)",

(B) in clause (i), by striking "for 'calendar year 1992' in subparagraph (B) thereof" and inserting "for 'calendar year 2016' in clause (ii) thereof", and

(C) in clause (ii), by striking "for 'calendar year 1992' in subparagraph (B) of such section 1" and inserting "for 'calendar year 2016' in clause (ii) thereof".

(3) Section 36B(b)(3)(A)(ii)(II) is amended by striking "consumer price index" and inserting "C-CPI-U (as defined in section 1(c))".

(4) Section 41(e)(5)(C) is amended to read as follows:

"(C) COST-OF-LIVING ADJUSTMENT DEFINED.—

"(i) IN GENERAL.—The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(c)(2)(A), by substituting 'calendar year 1987' for 'calendar year 2016' in clause (ii) thereof.

"(ii) SPECIAL RULE WHERE BASE PERIOD ENDS IN A CALENDAR YEAR OTHER THAN 1983 OR 1984.—If the base period of any taxpayer does not end in 1983 or 1984, clause (i) shall be applied by substituting the calendar year in which such base period ends for 1987.".

(5) Section 42(e)(3)(D)(ii) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 2008' for 'calendar year 1992' in sub-

paragraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year by substituting 'calendar year 2008' for 'calendar year 2016' in clause (ii) thereof".

(6) Section 42(h)(3)(H)(i)(II) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 2001' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year by substituting 'calendar year 2001' for 'calendar year 2016' in clause (ii) thereof".

(7) Section 45R(d)(3)(B)(ii) is amended by striking "section 1(f)(3) for the calendar year, determined by substituting 'calendar year 2012' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "'section 1(c)(2)(A) for such calendar year, determined by substituting "calendar year 2012" for "calendar year 2016" in clause (ii) thereof'".

(8) Section 125(i)(2) is amended—

(A) by striking "section 1(f)(3) for the calendar year in which the taxable year begins by substituting 'calendar year 2012' for 'calendar year 1992' in subparagraph (B) thereof" in subparagraph (B) and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins", and

(B) by striking "$50" both places it appears in the last sentence and inserting "$100".

(9) Section 162(o)(3) is amended by inserting "as in effect before enactment of the Tax Cuts and Jobs Act" after "section 1(f)(5)".

(10) Section 220(g)(2) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins by substituting 'calendar year 1997' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 1997' for 'calendar year 2016' in clause (ii) thereof".

(11) Section 223(g)(1) is amended by striking all that follows subparagraph (A) and inserting the following:

"(B) the cost-of-living adjustment determined under section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined—

"(i) by substituting for 'calendar year 2016' in clause (ii) thereof—

"(I) except as provided in clause (ii), 'calendar year 1997', and

"(II) in the case of each dollar amount in subsection (c)(2)(A), 'calendar year 2003', and

"(ii) by substituting 'March 31' for 'August 31' in paragraphs (5)(B) and (6)(B) of section 1(c).

The Secretary shall publish the dollar amounts as adjusted under this subsection for taxable years beginning in any calendar year no later than June 1 of the preceding calendar year.".

(12) Section 430(c)(7)(D)(vii)(II) is amended by striking "section 1(f)(3) for the calendar year, determined by substituting 'calendar year 2009' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year, determined by substituting 'calendar year 2009' for 'calendar year 2016' in clause (ii) thereof".

(13) Section 512(d)(2)(B) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 1994' for 'calendar year 1992' in subparagraph (B) thereof"and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 1994' for 'calendar year 2016' in clause (ii) thereof".

(14) Section 513(h)(2)(C)(ii) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins by substituting 'calendar year 1987' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 1987' for 'calendar year 2016' in clause (ii) thereof".

(15) Section 831(b)(2)(D)(ii) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 2013' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year by substituting 'calendar year 2013' for 'calendar year 2016' in clause (ii) thereof".

(16) Section 877A(a)(3)(B)(i)(II) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 2007' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2007' for 'calendar year 2016' in clause (ii) thereof".

(17) Section 911(b)(2)(D)(ii)(II) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2004' for '1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A)

for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2004' for 'calendar year 2016' in clause (ii) thereof".

(18) Section 1274A(d)(2) is amended to read as follows:

"(2) INFLATION ADJUSTMENT.—

"(A) IN GENERAL.—In the case of any debt instrument arising out of a sale or exchange during any calendar year after 2018, each adjusted dollar amount shall be increased by an amount equal to—

"(i) such adjusted dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.

"(B) ADJUSTED DOLLAR AMOUNTS.—For purposes of this paragraph, the term 'adjusted dollar amount' means the dollar amounts in subsections (b) and (c), in each case as in effect for calendar year 2018.

"(C) ROUNDING.—Any increase under subparagraph (A) shall be rounded to the nearest multiple of $100.".

(19) Section 2010(c)(3)(B)(ii) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 2010' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 2010' for 'calendar year 2016' in clause (ii) thereof".

(20) Section 2032A(a)(3)(B) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 1997' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 1997' for 'calendar year 2016' in clause (ii) thereof".

(21) Section 2503(b)(2)(B) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 1997' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year, determined by substituting 'calendar year 1997' for 'calendar year 2016' in clause (ii) thereof".

(22) Section 4161(b)(2)(C)(i)(II) is amended by striking "section 1(f)(3) for such calendar year, determined by substituting '2004' for '1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 2004' for 'calendar year 2016' in clause (ii) thereof".

(23) Section 4261(e)(4)(A)(ii) is amended by striking "section 1(f)(3) for such calendar year by substituting the year before the last nonindexed year for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year, determined by substituting the year before the last nonindexed year for 'calendar year 2016' in clause (ii) thereof".

(24) Section 4980I(b)(3)(C)(v)(II) is amended—

(A) by striking "section 1(f)(3)" and inserting "section 1(c)(2)(A)",

(B) by striking "subparagraph (B)" and inserting "clause (ii)", and

(C) by striking "1992" and inserting "2016".

(25) Section 5000A(c)(3)(D)(ii) is amended—

(A) by striking "section 1(f)(3)" and inserting "section 1(c)(2)(A)",

(B) by striking "subparagraph (B)" and inserting "clause (ii)", and

(C) by striking "1992" and inserting "2016".

(26) Section 6039F(d) is amended by striking "section 1(f)(3), except that subparagraph (B) thereof" and inserting "section 1(c)(2)(A), except that clause (ii) thereof".

(27) Section 6323(i)(4)(B) is amended by striking "section 1(f)(3) for the calendar year, determined by substituting 'calendar year 1996' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year, determined by substituting 'calendar year 1996' for 'calendar year 2016' in clause (ii) thereof".

(28) Section 6334(g)(1)(B) is amended by striking "section 1(f)(3) for such calendar year, by substituting 'calendar year 1998' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 1999' for 'calendar year 2016' in clause (ii) thereof".

(29) Section 6601(j)(3)(B) is amended by striking "section 1(f)(3) for such calendar year by substituting 'calendar year 1997' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for such calendar year by substituting 'calendar year 1997' for 'calendar year 2016' in clause (ii) thereof".

(30) Section 6651(i)(1) is amended by striking "section 1(f)(3) determined by substituting 'calendar year 2013' for 'calendar year 1992' in subparagraph (B)

thereof" and inserting "section 1(c)(2)(A) determined by substituting 'calendar year 2013' for 'calendar year 2016' in clause (ii) thereof".

(31) Section 6721(f)(1) is amended—

(A) by striking "section 1(f)(3)" and inserting "section 1(c)(2)(A)",

(B) by striking "subparagraph (B)" and inserting "clause (ii)", and

(C) by striking "1992" and inserting "2016".

(32) Section 6722(f)(1) is amended—

(A) by striking "section 1(f)(3)" and inserting "section 1(c)(2)(A)",

(B) by striking "subparagraph (B)" and inserting "clause (ii)", and

(C) by striking "1992" and inserting "2016".

(33) Section 6652(c)(7)(A) is amended by striking "section 1(f)(3) determined by substituting 'calendar year 2013' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) determined by substituting 'calendar year 2013' for 'calendar year 2016' in clause (ii) thereof".

(34) Section 6695(h)(1) is amended by striking "section 1(f)(3) determined by substituting 'calendar year 2013' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) determined by substituting 'calendar year 2013' for 'calendar year 2016' in clause (ii) thereof".

(35) Section 6698(e)(1) is amended by striking "section 1(f)(3) determined by substituting 'calendar year 2013' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) determined by substituting 'calendar year 2013' for 'calendar year 2016' in clause (ii) thereof".

(36) Section 6699(e)(1) is amended by striking "section 1(f)(3) determined by substituting 'calendar year 2013' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) determined by substituting 'calendar year 2013' for 'calendar year 2016' in clause (ii) thereof".

(37) Section 7345(f)(2) is amended by striking "section 1(f)(3) for the calendar year, determined by substituting 'calendar year 2015' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year, determined by substituting 'calendar year 2015' for 'calendar year 2016' in clause (ii) thereof".

(38) Section 7430(c)(1) is amended by striking "section 1(f)(3) for such calendar year, by substituting 'calendar year 1995' for 'calendar year 1992' in subparagraph (B) thereof" in the flush text at the end and inserting "section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 1995' for 'calendar year 2016' in clause (ii) thereof".

(39) Section 7872(g)(5) is amended to read as follows:

"(5) INFLATION ADJUSTMENT.—

"(A) IN GENERAL.—In the case of any loan made during any calendar year after 2018 to which paragraph (1) applies, the adjusted dollar amount shall be increased by an amount equal to—

"(i) such adjusted dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(c)(2)(A) for such calendar year, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.

"(B) ADJUSTED DOLLAR AMOUNT.—For purposes of this paragraph, the term 'adjusted dollar amount' means the dollar amount in paragraph (2) as in effect for calendar year 2018.

"(C) ROUNDING.—Any increase under subparagraph (A) shall be rounded to the nearest multiple of $100.".

(40) Section 219(b)(5)(C)(i)(II) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2007' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2007' for 'calendar year 2016' in clause (ii) thereof".

(41) Section 219(g)(8)(B) is amended by striking "section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2005' for 'calendar year 1992' in subparagraph (B) thereof" and inserting "section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2005' for 'calendar year 2016' in clause (ii) thereof".

(b) OTHER CONFORMING AMENDMENTS.—

(1) Section 36B(b)(3)(B)(ii)(I)(aa) is amended to read as follows:

"(aa) who is described in section 1(b)(1)(B) and who does not have any dependents for the taxable year,".

(2) Section 486B(b)(1) is amended—

(A) by striking "maximum rate in effect" and inserting "highest rate specified", and

(B) by striking “section 1(e)” and inserting “section 1”.

(3) Section 511(b)(1) is amended by striking “section 1(e)” and inserting “section 1”.

(4) Section 641(a) is amended by striking “section 1(e) shall apply to the taxable income” and inserting “section 1 shall apply to the taxable income”.

(5) Section 641(c)(2)(A) is amended to read as follows:

“(A) Except to the extent provided in section 1(h), the rate of tax shall be treated as being the highest rate of tax set forth in section 1(a).”.

(6) Section 646(b) is amended to read as follows:

“(b) TAXATION OF INCOME OF TRUST.—Except as provided in subsection (f)(1)(B)(ii), there is hereby imposed on the taxable income of an electing Settlement Trust a tax at the rate specified in section 1(a)(1). Such tax shall be in lieu of the income tax otherwise imposed by this chapter on such income.”.

(7) Section 685(c) is amended by striking “Section 1(e)” and inserting “Section 1”.

(8) Section 904(b)(3)(E)(ii)(I) is amended by striking “set forth in subsection (a), (b), (c), (d), or (e) of section 1 (whichever applies)” and inserting “the highest rate of tax specified in section 1”.

(9) Section 1398(c)(2) is amended by striking “subsection (d) of”.

(10) Section 3402(p)(1)(B) is amended by striking “any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c),” and inserting “12 percent, 25 percent,”.

(11) Section 3402(q)(1) is amended by striking “the product of third lowest rate of tax applicable under section 1(c) and” and inserting “25 percent of”.

(12) Section 3402(r)(3) is amended by striking “the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of the fourth lowest rate of tax applicable under section 1(c)) on an amount of taxable income equal to” and inserting “an amount equal to the product of 25 percent multiplied by”.

(13) Section 3406(a)(1) is amended by striking “the product of the fourth lowest rate of tax applicable under section 1(c) and” and inserting “25 percent of”.

(14) Section 6103(e)(1)(A)(iii) is amended by inserting “(as in effect on the day before the date of the enactment of the Tax Cuts and Jobs Act)” after “section 1(g)”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle B—Simplification and Reform of Family and Individual Tax Credits

SEC. 1101. ENHANCEMENT OF CHILD TAX CREDIT AND NEW FAMILY TAX CREDIT.

(a) INCREASE IN CREDIT AMOUNT AND ADDITION OF OTHER DEPENDENTS.—

(1) IN GENERAL.—Section 24(a) is amended to read as follows:

“(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

“(1) with respect to each qualifying child of the taxpayer, $1,600, and

“(2) for taxable years beginning before January 1, 2023, with respect to the taxpayer (each spouse in the case of a joint return) and each dependent of the taxpayer to whom paragraph (1) does not apply, $300.”.

(2) CONFORMING AMENDMENTS.—

(A) Section 24(c) is amended—

(i) by redesignating paragraphs (1) and (2) as paragraphs (2) and (3), respectively,

(ii) by striking “152(c)” in paragraph (2) (as so redesignated) and inserting “7706(c)”,

(iii) by inserting before paragraph (2) (as so redesignated) the following new paragraph:

“(1) DEPENDENT.—

“(A) IN GENERAL.—The term ‘dependent’ shall have the meaning given such term by section 7706.

“(B) CERTAIN INDIVIDUALS NOT TREATED AS DEPENDENTS.—In the case of an individual with respect to whom a credit under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual’s taxable year begins, the amount applicable to such individual under subsection (a) for such individual’s taxable year shall be zero.”,

(iv) in paragraph (3) (as so redesignated)—

(I) by striking "term 'qualifying child'" and inserting "terms 'qualifying child' and 'dependent'", and

(II) by striking "152(b)(3)" and inserting "7706(b)(3)", and

(v) in the heading by striking "QUALIFYING" and inserting "DEPENDENT; QUALIFYING".

(B) The heading for section 24 is amended by inserting "**AND FAMILY**" after "**CHILD**".

(C) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking the item relating to section 24 and inserting the following new item:

"Sec. 24. Child and family tax credit.".

(b) ELIMINATION OF MARRIAGE PENALTY.—Section 24(b)(2) is amended—

(1) by striking "$110,000" in subparagraph (A) and inserting "$230,000",

(2) by inserting "and" at the end of subparagraph (A),

(3) by striking "$75,000 in the case of an individual who is not married" and all that follows through the period at the end and inserting "one-half of the amount in effect under subparagraph (A) for the taxable year in the case of any other individual.".

(c) CREDIT REFUNDABLE UP TO $1,000 PER CHILD.—

(1) IN GENERAL.—Section 24(d)(1)(A) is amended by striking all that follows "under this section" and inserting the following: "determined—

"(i) without regard to this subsection and the limitation under section 26(a),

"(ii) without regard to subsection (a)(2), and

"(iii) by substituting '$1,000' for '$1,600' in subsection (a)(1), or".

(2) INFLATION ADJUSTMENT.—Section 24(d) is amended by inserting after paragraph (2) the following new paragraph:

"(3) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2017, the $1,000 amount in paragraph (1)(A)(iii) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment under section 1(c)(2)(A) for such calendar year.

Any increase determined under the preceding sentence shall be rounded to the next highest multiple of $100 and shall not exceed the amount in effect under subsection (a)(2).".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1102. REPEAL OF NONREFUNDABLE CREDITS.

(a) REPEAL OF SECTION 22.—

(1) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 is amended by striking section 22 (and by striking the item relating to such section in the table of sections for such subpart).

(2) CONFORMING AMENDMENT.—

(A) Section 86(f) is amended by striking paragraph (1) and by redesignating paragraphs (2), (3), and (4) as paragraphs (1), (2), and (3), respectively.

(B)(i) Subsections (c)(3)(B) and (d)(4)(A) of section 7706, as redesignated by this Act, are each amended by striking "(as defined in section 22(e)(3)".

(ii) Section 7706(f), as redesignated by this Act, is amended by redesignating paragraph (7) as paragraph (8) and by inserting after paragraph (6) the following new paragraph:

"(7) PERMANENT AND TOTAL DISABILITY DEFINED.—An individual is permanently and totally disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. An individual shall not be considered to be permanently and totally disabled unless he furnishes proof of the existence thereof in such form and manner, and at such times, as the Secretary may require.".

(iii) Section 415(c)(3)(C)(i) is amended by striking "22(e)(3)" and inserting "7706(f)(7)".

(iv) Section 422(c)(6) is amended by striking "22(e)(3)" and inserting "7706(f)(7)".

(b) TERMINATION OF SECTION 25.—Section 25, as amended by section 3601, is amended by adding at the end the following new subsection:

"(k) TERMINATION.—No credit shall be allowed under this section with respect to any mortgage credit certificate issued after December 31, 2017.".

(c) REPEAL OF SECTION 30D.—

(1) IN GENERAL.—Subpart B of part IV of subchapter A of chapter 1 is amended by striking section 30D (and by striking the item relating to such section in the table of sections for such subpart).

(2) CONFORMING AMENDMENTS.—

(A) Section 38(b) is amended by striking paragraph (35).

(B) Section 1016(a) is amended by striking paragraph (37).

(C) Section 6501(m) is amended by striking "30D(e)(4),".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) SUBSECTION (b).—The amendment made by subsection (c) shall apply to taxable years ending after December 31, 2017.

(3) SUBSECTION (c).—The amendments made by subsection (d) shall apply to vehicles placed in service in taxable years beginning after December 31, 2017.

SEC. 1103. REFUNDABLE CREDIT PROGRAM INTEGRITY.

(a) IDENTIFICATION REQUIREMENTS FOR CHILD AND FAMILY TAX CREDIT.—

(1) IN GENERAL.—Section 24(e) is amended to read as follows:

"(e) IDENTIFICATION REQUIREMENTS.—

"(1) REQUIREMENTS FOR QUALIFYING CHILD.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the name and social security number of such qualifying child on the return of tax for the taxable year. The preceding sentence shall not prevent a qualifying child from being treated as a dependent described in subsection (a)(2).

"(2) OTHER IDENTIFICATION REQUIREMENTS.—No credit shall be allowed under this section with respect to any individual unless the taxpayer identification number of such individual is included on the return of tax for the taxable year and such identifying number was issued before the due date for filing the return for the taxable year.

"(3) SOCIAL SECURITY NUMBER.—For purposes of this subsection, the term 'social security number' means a social security number issued by the Social Security Administration (but only if the social security number is issued to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act)).".

(2) OMISSIONS TREATED AS MATHEMATICAL OR CLERICAL ERROR.—

(A) IN GENERAL.—Section 6213(g)(2)(I) is amended to read as follows:

"(I) an omission of a correct social security number, or a correct TIN, required under section 24(e) (relating to child tax credit), to be included on a return,".

(b) SOCIAL SECURITY NUMBER MUST BE PROVIDED.—

(1) IN GENERAL.—Section 25A(f)(1)(A), as amended by section 1201 of this Act, is amended by striking "taxpayer identification number" each place it appears and inserting "social security number".

(2) OMISSION TREATED AS MATHEMATICAL OR CLERICAL ERROR.—Section 6213(g)(2)(J) is amended by striking "TIN" and inserting "social security number and employer identification number".

(c) INDIVIDUALS PROHIBITED FROM ENGAGING IN EMPLOYMENT IN UNITED STATES NOT ELIGIBLE FOR EARNED INCOME TAX CREDIT.—Section 32(m) is amended—

(1) by striking "(other than:" and all that follows through "of the Social Security Act)", and

(2) by inserting before the period at the end the following: ", but only if, in the case of subsection (c)(1)(E), the social security number is issued to a citizen of the United States or pursuant to subclause (I) (or that portion of subclause (III) that relates to subclause (I)) of section 205(c)(2)(B)(i) of the Social Security Act".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1104. PROCEDURES TO REDUCE IMPROPER CLAIMS OF EARNED INCOME CREDIT.

(a) CLARIFICATION REGARDING DETERMINATION OF SELF-EMPLOYMENT INCOME WHICH IS TREATED AS EARNED INCOME.—Section 32(c)(2)(B) is amended by striking "and" at the end of clause (v), by striking the period at the end of clause (vi) and inserting ", and", and by adding at the end the following new clause:

"(vii) in determining the taxpayer's net earnings from self-employment under subparagraph (A)(ii) there shall not fail to be taken into account any deduction which is allowable to the taxpayer under this subtitle.".

(b) REQUIRED QUARTERLY REPORTING OF WAGES OF EMPLOYEES.—Section 6011 is amended by adding at the end the following new subsection:

"(i) EMPLOYER REPORTING OF WAGES.—Every person required to deduct and withhold from an employee a tax under section 3101 or 3402 shall include on each return or statement submitted with respect to such tax, the name and address of such employee and the amount of wages for such employee on which such tax was withheld.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

(2) REPORTING.—The Secretary of the Treasury, or his designee, may delay the application of the amendment made by subsection (b) for such period as such Secretary (or designee) determines to be reasonable to allow persons adequate time to modify electronic (or other) systems to permit such person to comply with the requirements of such amendment.

SEC. 1105. CERTAIN INCOME DISALLOWED FOR PURPOSES OF THE EARNED INCOME TAX CREDIT.

(a) SUBSTANTIATION REQUIREMENT.—Section 32 is amended by adding at the end the following new subsection:

"(n) INCONSISTENT INCOME REPORTING.—If the earned income of a taxpayer claimed on a return for purposes of this section is not substantiated by statements or returns under sections 6051, 6052, 6041(a), or 6050W with respect to such taxpayer, the Secretary may require such taxpayer to provide books and records to substantiate such income, including for the purpose of preventing fraud.".

(b) EXCLUSION OF UNSUBSTANTIATED AMOUNT FROM EARNED INCOME.—Section 32(c)(2) is amended by adding at the end the following new subparagraph:

"(C) EXCLUSION.—In the case of a taxpayer with respect to which there is an inconsistency described in subsection (n) who fails to substantiate such inconsistency to the satisfaction of the Secretary, the term 'earned income' shall not include amounts to the extent of such inconsistency.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

Subtitle C—Simplification and Reform of Education Incentives

SEC. 1201. AMERICAN OPPORTUNITY TAX CREDIT.

(a) IN GENERAL.—Section 25A is amended to read as follows:

"SEC. 25A. AMERICAN OPPORTUNITY TAX CREDIT.

"(a) IN GENERAL.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the sum of—

"(1) 100 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished to any eligible student for whom an election is in effect under this section for such taxable year during any academic period beginning in such taxable year) as does not exceed $2,000, plus

"(2) 25 percent of so much of such expenses so paid as exceeds the dollar amount in effect under paragraph (1) but does not exceed twice such dollar amount.

"(b) PORTION OF CREDIT REFUNDABLE.—40 percent of the credit allowable under subsection (a)(1) (determined without regard to this subsection and section 26(a) and after application of all other provisions of this section) shall be treated as a credit allowable under subpart C (and not under this part). The preceding sentence shall not apply to any taxpayer for any taxable year if such taxpayer is a child to whom section 1(d) applies for such taxable year.

"(c) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—The amount allowable as a credit under subsection (a) for any taxable year shall be reduced (but not below zero) by an amount which bears the same ratio to the amount so allowable (determined without regard to this subsection and subsection (b) but after application of all other provisions of this section) as—

"(A) the excess of—

"(i) the taxpayer's modified adjusted gross income for such taxable year, over

"(ii) $80,000 (twice such amount in the case of a joint return), bears to

"(B) $10,000 (twice such amount in the case of a joint return).

"(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

"(d) OTHER LIMITATIONS.—

"(1) CREDIT ALLOWED ONLY FOR 5 TAXABLE YEARS.—An election to have this section apply may not be made for any taxable year if such an election (by the taxpayer or any other individual) is in effect with respect to such student for any 5 prior taxable years.

"(2) CREDIT ALLOWED ONLY FOR FIRST 5 YEARS OF POSTSECONDARY EDUCATION.—

"(A) IN GENERAL.—No credit shall be allowed under subsection (a) for a taxable year with respect to the qualified tuition and related expenses of an eligible student if the student has completed (before the beginning of such taxable year) the first 5 years of postsecondary education at an eligible educational institution.

"(B) FIFTH YEAR LIMITATIONS.—In the case of an eligible student with respect to whom an election has been in effect for 4 preceding taxable years for purposes of the fifth taxable year—

"(i) the amount of the credit allowed under this section for the taxable year shall not exceed an amount equal to 50 percent of the credit otherwise determined with respect to such student under this section (without regard to this subparagraph), and

"(ii) the amount of the credit determined under subsection (b) and allowable under subpart C shall not exceed an amount equal to 40 percent of the amount determined with respect to such student under clause (i).

"(e) DEFINITIONS.—For purposes of this section—

"(1) ELIGIBLE STUDENT.— The term 'eligible student' means, with respect to any academic period, a student who—

"(A) meets the requirements of section 484(a)(1) of the Higher Education Act of 1965 (20 U.S.C. 1091(a)(1)), as in effect on August 5, 1997, and

"(B) is carrying at least ½ the normal full-time work load for the course of study the student is pursuing.

"(2) QUALIFIED TUITION AND RELATED EXPENSES.—

"(A) IN GENERAL.—The term 'qualified tuition and related expenses' means tuition, fees, and course materials, required for enrollment or attendance of—

"(i) the taxpayer,

"(ii) the taxpayer's spouse, or

"(iii) any dependent of the taxpayer,

at an eligible educational institution for courses of instruction of such individual at such institution.

"(B) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC.—Such term does not include expenses with respect to any course or other education involving sports, games, or hobbies, unless such course or other education is part of the individual's degree program.

"(C) EXCEPTION FOR NONACADEMIC FEES.—Such term does not include student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

"(3) ELIGIBLE EDUCATIONAL INSTITUTION.—The term 'eligible educational institution' means an institution—

"(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on August 5, 1997, and

"(B) which is eligible to participate in a program under title IV of such Act.

"(f) SPECIAL RULES.—

"(1) IDENTIFICATION REQUIREMENTS.—

"(A) STUDENT.—No credit shall be allowed under subsection (a) to a taxpayer with respect to the qualified tuition and related expenses of an individual unless the taxpayer includes the name and taxpayer identification number of such individual on the return of tax for the taxable year, and such taxpayer identification number was issued on or before the due date for filing such return.

"(B) TAXPAYER.—No credit shall be allowed under this section if the identifying number of the taxpayer was issued after the due date for filing the return for the taxable year.

"(C) INSTITUTION.—No credit shall be allowed under this section unless the taxpayer includes the employer identification number of any institution to which qualified tuition and related expenses were paid with respect to the individual.

"(2) ADJUSTMENT FOR CERTAIN SCHOLARSHIPS, ETC.—The amount of qualified tuition and related expenses otherwise taken into account under subsection (a) with respect to an individual for an academic period shall be reduced (before the application of subsection (c)) by the sum of any amounts paid for the benefit of such individual which are allocable to such period as—

"(A) a qualified scholarship which is excludable from gross income under section 117,

"(B) an educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code, and

"(C) a payment (other than a gift, bequest, devise, or inheritance within the meaning of section 102(a)) for such individual's educational expenses, or attributable to such individual's enrollment at an eligible educational institution, which is excludable from gross income under any law of the United States.

"(3) TREATMENT OF EXPENSES PAID BY DEPENDENT.—If an individual is a dependent of another taxpayer for a taxable year beginning in the calendar year in which such individuals taxable year begins—

"(A) no credit shall be allowed under subsection (a) to such individual for such individual's taxable year, and

"(B) qualified tuition and related expenses paid by such individual during such individual's taxable year shall be treated for purposes of this section as paid by such other taxpayer.

"(4) TREATMENT OF CERTAIN PREPAYMENTS.—If qualified tuition and related expenses are paid by the taxpayer during a taxable year for an academic period which begins during the first 3 months following such taxable year, such academic period shall be treated for purposes of this section as beginning during such taxable year.

"(5) DENIAL OF DOUBLE BENEFIT.—No credit shall be allowed under this section for any amount for which a deduction is allowed under any other provision of this chapter.

"(6) NO CREDIT FOR MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

"(7) NONRESIDENT ALIENS.—If the taxpayer is a nonresident alien individual for any portion of the taxable year, this section shall apply only if such individual is treated as a resident alien of the United States for purposes of this chapter by reason of an election under subsection (g) or (h) of section 6013.

"(8) RESTRICTIONS ON TAXPAYERS WHO IMPROPERLY CLAIMED CREDIT IN PRIOR YEAR.—

"(A) TAXPAYERS MAKING PRIOR FRAUDULENT OR RECKLESS CLAIMS.—

"(i) IN GENERAL.—No credit shall be allowed under this section for any taxable year in the disallowance period.

"(ii) DISALLOWANCE PERIOD.—For purposes of clause (i), the disallowance period is—

"(I) the period of 10 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to fraud, and

"(II) the period of 2 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to reckless or intentional disregard of rules and regulations (but not due to fraud).

"(B) TAXPAYERS MAKING IMPROPER PRIOR CLAIMS.—In the case of a taxpayer who is denied credit under this section for any taxable year as a result of the deficiency procedures under subchapter B of chapter 63, no credit shall be allowed under this section for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for such credit.

"(g) INFLATION ADJUSTMENT.—

"(1) IN GENERAL.—In the case of a taxable year beginning after 2018, the $80,000 amount in subsection (c)(1)(A)(ii) shall each be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(c)(2)(A) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2017' for 'calendar year 2016' in clause (ii) thereof.

"(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of $1,000, such amount shall be rounded to the next lowest multiple of $1,000.

"(h) REGULATIONS.—The Secretary may prescribe such regulations or other guidance as may be necessary or appropriate to carry out this section, including regulations providing for a recapture of the credit allowed under this section in cases where there is a refund in a subsequent taxable year of any amount which was taken into account in determining the amount of such credit.".

(b) CONFORMING AMENDMENTS.—

(1) Section 72(t)(7)(B) is amended by striking "section 25A(g)(2)" and inserting "section 25A(f)(2)".

(2) Section 529(c)(3)(B)(v)(I) is amended by striking "section 25A(g)(2)" and inserting "section 25A(f)(2)".

(3) Section 529(e)(3)(B)(i) is amended by striking "section 25A(b)(3)" and inserting "section 25A(d)".

(4) Section 530(d)(2)(C) is amended—

(A) by striking "section 25A(g)(2)" in clause (i)(I) and inserting "section 25A(f)(2)", and

(B) by striking "HOPE AND LIFETIME LEARNING CREDITS" in the heading and inserting "AMERICAN OPPORTUNITY TAX CREDIT".

(5) Section 530(d)(4)(B)(iii) is amended by striking "section 25A(g)(2)" and inserting "section 25A(d)(4)(B)".

(6) Section 6050S(e) is amended by striking "subsection (g)(2)" and inserting "subsection (f)(2)".

(7) Section 6211(b)(4)(A) is amended by striking "subsection (i)(6)" and inserting "subsection (b)".

(8) Section 6213(g)(2)(J) is amended by striking "TIN required under section 25A(g)(1)" and inserting "TIN, and employer identification number, required under section 25A(f)(1)".

(9) Section 6213(g)(2)(Q) is amended to read as follows:

"(Q) an omission of information required by section 25A(f)(8)(B) or an entry on the return claiming the credit determined under section 25A(a) for a taxable year for which the credit is disallowed under section 25A(f)(8)(A).".

(10) Section 1004(c) of division B of the American Recovery and Reinvestment Tax Act of 2009 is amended—

(A) in paragraph (1)—

(i) by striking "section 25A(i)(6)" each place it appears and inserting "section 25A(b)", and

(ii) by striking "with respect to taxable years beginning after 2008 and before 2018" each place it appears and inserting "with respect to each taxable year",

(B) in paragraph (2), by striking "Section 25A(i)(6)" and inserting "Section 25A(b)", and

(C) in paragraph (3)(C), by striking "subsection (i)(6)" and inserting "subsection (b)".

(11) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking the item relating to section 25A and inserting the following new item:

"Sec. 25A. American opportunity tax credit.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1202. CONSOLIDATION OF EDUCATION SAVINGS RULES.

(a) NO NEW CONTRIBUTIONS TO COVERDELL EDUCATION SAVINGS ACCOUNT.—Section 530(b)(1)(A) is amended to read as follows:

"(A) Except in the case of rollover contributions, no contribution will be accepted after December 31, 2017.".

(b) LIMITED DISTRIBUTION ALLOWED FOR ELEMENTARY AND SECONDARY TUITION.—

(1) IN GENERAL.—Section 529(c) is amended by adding at the end the following new paragraph:

"(7) TREATMENT OF ELEMENTARY AND SECONDARY TUITION.—Any reference in this subsection to the term 'qualified higher education expense' shall include a reference to expenses for tuition in connection with enrollment at an elementary or secondary school.".

(2) LIMITATION.—Section 529(e)(3)(A) is amended by adding at the end the following: "The amount of cash distributions from all qualified tuition programs described in subsection (b)(1)(A)(ii) with respect to a beneficiary during any taxable year, shall, in the aggregate, include not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the beneficiary as an elementary or secondary school student at a public, private, or religious school.".

(c) ROLLOVERS TO QUALIFIED TUITION PROGRAMS PERMITTED.—Section 530(d)(5) is amended by inserting ", or into (by purchase or contribution) a qualified tuition program (as defined in section 529)," after "into another Coverdell education savings account".

(d) DISTRIBUTIONS FROM QUALIFIED TUITION PROGRAMS FOR CERTAIN EXPENSES ASSOCIATED WITH REGISTERED APPRENTICESHIP PROGRAMS.—Section 529(e)(3) is amended by adding at the end the following new subparagraph:

"(C) CERTAIN EXPENSES ASSOCIATED WITH REGISTERED APPRENTICESHIP PROGRAMS.—The term 'qualified higher education expenses' shall include books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary in an apprenticeship program registered and certified with the Secretary of Labor under section 1 of the National Apprenticeship Act (29 U.S.C. 50).".

(e) UNBORN CHILDREN ALLOWED AS ACCOUNT BENEFICIARIES.—Section 529(e) is amended by adding at the end the following new paragraph:

"(6) TREATMENT OF UNBORN CHILDREN.—

"(A) IN GENERAL.—Nothing shall prevent an unborn child from being treated as a designated beneficiary or an individual under this section.

"(B) UNBORN CHILD.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'unborn child' means a child in utero.

"(ii) CHILD IN UTERO.—The term 'child in utero' means a member of the species homo sapiens, at any stage of development, who is carried in the womb.".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to contributions made after December 31, 2017.

(2) ROLLOVERS TO QUALIFIED TUITION PROGRAMS.—The amendments made by subsection (b) shall apply to distributions after December 31, 2017.

SEC. 1203. REFORMS TO DISCHARGE OF CERTAIN STUDENT LOAN INDEBTEDNESS.

(a) TREATMENT OF STUDENT LOANS DISCHARGED ON ACCOUNT OF DEATH OR DISABILITY.—Section 108(f) is amended by adding at the end the following new paragraph:

"(5) DISCHARGES ON ACCOUNT OF DEATH OR DISABILITY.—

"(A) IN GENERAL.—In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reasons of the discharge (in whole or in part) of any loan described in subparagraph (B) if such discharge was—

"(i) pursuant to subsection (a) or (d) of section 437 of the Higher Education Act of 1965 or the parallel benefit under part D of title IV of such Act (relating to the repayment of loan liability),

"(ii) pursuant to section 464(c)(1)(F) of such Act, or

"(iii) otherwise discharged on account of the death or total and permanent disability of the student.

"(B) LOANS DESCRIBED.—A loan is described in this subparagraph if such loan is—

"(i) a student loan (as defined in paragraph (2)), or

"(ii) a private education loan (as defined in section 140(7) of the Consumer Credit Protection Act (15 U.S.C. 1650(7))).".

(b) EXCLUSION FROM GROSS INCOME FOR PAYMENTS MADE UNDER INDIAN HEALTH SERVICE LOAN REPAYMENT PROGRAM.—

(1) IN GENERAL.—Section 108(f)(4) is amended by inserting "under section 108 of the Indian Health Care Improvement Act," after "338I of such Act,".

(2) CLERICAL AMENDMENT.—The heading for section 108(f)(4) is amended by striking "AND CERTAIN" and inserting ", INDIAN HEALTH SERVICE LOAN REPAYMENT PROGRAM, AND CERTAIN".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendment made by subsection (a)(1) shall apply to discharges of indebtedness after December 31, 2017.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to amounts received in taxable years beginning after December 31, 2017.

SEC. 1204. REPEAL OF OTHER PROVISIONS RELATING TO EDUCATION.

(a) IN GENERAL.—Subchapter B of chapter 1 is amended—

(1) in part VII by striking sections 221 and 222 (and by striking the items relating to such sections in the table of sections for such part),

(2) in part VII by striking sections 135 and 127 (and by striking the items relating to such sections in the table of sections for such part), and

(3) by striking subsection (d) of section 117.

(b) CONFORMING AMENDMENT RELATING TO SECTION 221.—

(1) Section 62(a) is amended by striking paragraph (17).

(2) Section 74(d) is amended by striking "221,".

(3) Section 86(b)(2)(A) is amended by striking "221,".

(4) Section 219(g)(3)(A)(ii) is amended by striking "221,".

(5) Section 163(h)(2) is amended by striking subparagraph (F).

(6) Section 6050S(a) is amended—

(A) by inserting "or" at the end of paragraph (1),

(B) by striking "or" at the end of paragraph (2), and

(C) by striking paragraph (3).

(7) Section 6050S(e) is amended by striking all that follows "thereof)" and inserting a period.

(c) CONFORMING AMENDMENTS RELATED TO SECTION 222.—

(1) Section 62(a) is amended by striking paragraph (18).

(2) Section 74(d)(2)(B) is amended by striking "222,".

(3) Section 86(b)(2)(A) is amended by striking "222,".

(4) Section 219(g)(3)(A)(ii) is amended by striking "222,".

(d) CONFORMING AMENDMENTS RELATING TO SECTION 127.—

(1) Section 125(f)(1) is amended by striking "127,".

(2) Section 132(j)(8) is amended by striking "which are not excludable from gross income under section 127".

(3) Section 414(n)(3)(C) is amended by striking "127,".

(4) Section 414(t)(2) is amended by striking "127,".

(5) Section 3121(a)(18) is amended by striking "127,".

(6) Section 3231(e) is amended by striking paragraph (6).

(7) Section 3306(b)(13) is amended by "127,".

(8) Section 3401(a)(18) is amended by striking "127,".

(9) Section 6039D(d)(1) is amended by striking ", 127".

(e) CONFORMING AMENDMENTS RELATING TO SECTION 117(d).—

(1) Section 117(c)(1) is amended—

(A) by striking "subsections (a) and (d)" and inserting "subsection (a)", and

(B) by striking "or qualified tuition reduction".

(2) Section 414(n)(3)(C) is amended by striking "117(d),".

(3) Section 414(t)(2) is amended by striking "117(d),".

(f) CONFORMING AMENDMENTS RELATED TO SECTION 135.—

(1) Section 74(d)(2)(B) is amended by striking "135,".

(2) Section 86(b)(2)(A) is amended by striking "135,".

(3) Section 219(g)(3)(A)(ii) is amended by striking "135,".

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) AMENDMENTS RELATING TO SECTION 117(d).—The amendments made by subsections (a)(3) and (e) shall apply to amounts paid or incurred after December 31, 2017.

SEC. 1205. ROLLOVERS BETWEEN QUALIFIED TUITION PROGRAMS AND QUALIFIED ABLE PROGRAMS.

(a) ROLLOVERS FROM QUALIFIED TUITION PROGRAMS TO QUALIFIED ABLE PROGRAMS.—Section 529(c)(3)(C)(i) is amended by striking "or" at the end of subclause (I), by striking the period at the end of subclause (II) and inserting ", or", and by adding at the end the following new subclause:

"(III) to an ABLE account (as defined in section 529A(e)(6)) of the designated beneficiary or a member of the family of the designated beneficiary.

Subclause (III) shall not apply to so much of a distribution which, when added to all other contributions made to the ABLE account for the taxable year, exceeds the limitation under section 529A(b)(2)(B).".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2017.

Subtitle D—Simplification and Reform of Deductions

SEC. 1301. REPEAL OF OVERALL LIMITATION ON ITEMIZED DEDUCTIONS.

(a) IN GENERAL.—Part 1 of subchapter B of chapter 1 is amended by striking section 68 (and the item relating to such section in the table of sections for such part).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1302. MORTGAGE INTEREST.

(a) MODIFICATION OF LIMITATIONS.—

(1) IN GENERAL.—Section 163(h)(3) is amended to read as follows:

"(3) QUALIFIED RESIDENCE INTEREST.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified residence interest' means any interest which is paid or accrued during the taxable year on indebtedness which—

"(i) is incurred in acquiring, constructing, or substantially improving any qualified residence (determined as of the time the interest is accrued) of the taxpayer, and

"(ii) is secured by such residence.

Such term also includes interest on any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

"(B) LIMITATION.—The aggregate amount of indebtedness taken into account under subparagraph (A) for any period shall not exceed $500,000 (half of such amount in the case of a married individual filing a separate return).

"(C) TREATMENT OF INDEBTEDNESS INCURRED ON OR BEFORE NOVEMBER 2, 2017.—

"(i) IN GENERAL.—In the case of any pre-November 2, 2017, indebtedness, this paragraph shall apply as in effect immediately before the enactment of the Tax Cuts and Jobs Act.

"(ii) PRE-NOVEMBER 2, 2017, INDEBTEDNESS.—For purposes of this subparagraph, the term 'pre-November 2, 2017, indebtedness' means—

"(I) any principal residence acquisition indebtedness which was incurred on or before November 2, 2017, or

"(II) any principal residence acquisition indebtedness which is incurred after November 2, 2017, to refinance indebtedness described in clause (i) (or refinanced indebtedness meeting the requirements of this clause) to the extent (immediately after the refinancing) the principal amount of the indebtedness resulting from the refinancing does not exceed the principal amount of the refinanced indebtedness (immediately before the refinancing).

"(iii) LIMITATION ON PERIOD OF REFINANCING.—clause (ii)(II) shall not apply to any indebtedness after—

"(I) the expiration of the term of the original indebtedness, or

"(II) if the principal of such original indebtedness is not amortized over its term, the expiration of the term of the 1st refinancing of such indebtedness (or if earlier, the date which is 30 years after the date of such 1st refinancing).

"(iv) BINDING CONTRACT EXCEPTION.—In the case of a taxpayer who enters into a written binding contract before November 2, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, subparagraphs (A) and (B) shall be applied by substituting 'April 1, 2018' for 'November 2, 2017'.".

(2) CONFORMING AMENDMENTS.—

(A) Section 108(h)(2) is by striking "for '$1,000,000 ($500,000' in clause (ii) thereof" and inserting "for '$500,000 ($250,000' in paragraph (2)(A), and '$1,000,000' for '$500,000' in paragraph (2)(B), thereof".

(B) Section 163(h) is amended by striking subparagraphs (E) and (F) in paragraph (4).

(b) TAXPAYERS LIMITED TO 1 QUALIFIED RESIDENCE.—Section 163(h)(4)(A)(i) is amended to read as follows:

"(i) IN GENERAL.—The term 'qualified residence' means the principal residence (within the meaning of section 121) of the taxpayer.".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to interest paid or accrued in taxable years beginning after December 31, 2017, with respect to indebtedness incurred before, on, or after such date.

(2) TREATMENT OF GRANDFATHERED INDEBTEDNESS.—For application of the amendments made by this section to grandfathered indebtedness, see paragraph (3)(C) of section 163(h) of the Internal Revenue Code of 1986, as amended by this section.

SEC. 1303. REPEAL OF DEDUCTION FOR CERTAIN TAXES NOT PAID OR ACCRUED IN A TRADE OR BUSINESS.

(a) IN GENERAL.—Section 164(b)(5) is amended to read as follows:

"(5) LIMITATION IN CASE OF INDIVIDUALS.—In the case of a taxpayer other than a corporation—

"(A) foreign real property taxes (other than taxes which are paid or accrued in carrying on a trade or business or an activity described in section 212) shall not be taken into account under subsection (a)(1),

"(B) the aggregate amount of taxes (other than taxes which are paid or accrued in carrying on a trade or business or an activity described in section 212) taken into account under subsection (a)(1) for any taxable year shall not exceed $10,000 ($5,000 in the case of a married individual filing a separate return),

"(C) subsection (a)(2) shall only apply to taxes which are paid or accrued in carrying on a trade or business or an activity described in section 212, and

"(D) subsection (a)(3) shall not apply to State and local taxes.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1304. REPEAL OF DEDUCTION FOR PERSONAL CASUALTY LOSSES.

(a) IN GENERAL.—Section 165(c) is amended by inserting "and" at the end of paragraph (1), by striking "; and" at the end of paragraph (2) and inserting a period, and by striking paragraph (3).

(b) CONFORMING AMENDMENTS.—

(1) Section 165(h) is amended to read as follows:

"(h) SPECIAL RULE WHERE PERSONAL CASUALTY GAINS EXCEED PERSONAL CASUALTY LOSSES.—

"(1) IN GENERAL.—If the personal casualty gains for any taxable year exceed the personal casualty losses for such taxable year—

"(A) all such gains shall be treated as gains from sales or exchanges of capital assets, and

"(B) all such losses shall be treated as losses from sales or exchanges of capital assets.

"(2) DEFINITIONS OF PERSONAL CASUALTY GAIN AND PERSONAL CASUALTY LOSS.—For purposes of this subsection—

"(A) PERSONAL CASUALTY LOSS.—The term 'personal casualty loss' means any loss of property not connected with a trade or business or a transaction entered into for profit, if such loss arises from fire, storm, shipwreck, or other casualty, or from theft.

"(B) PERSONAL CASUALTY GAIN.—The term 'personal casualty gain' means the recognized gain from any involuntary conversion of property which is described in subparagraph (A) arising from fire, storm, shipwreck, or other casualty, or from theft.".

(2) Section 165 is amended by striking subsection (k).

(3)(A) Section 165(l)(1) is amended by striking "a loss described in subsection (c)(3)" and inserting "an ordinary loss described in subsection (c)(2)".

(B) Section 165(l) is amended—

(i) by striking paragraph (5),

(ii) by redesignating paragraphs (2), (3), and (4) as paragraphs (3), (4), and (5), respectively, and

(iii) by inserting after paragraph (1) the following new paragraph:

"(2) LIMITATIONS.—

"(A) DEPOSIT MAY NOT BE FEDERALLY INSURED.—No election may be made under paragraph (1) with respect to any loss on a deposit in a qualified financial institution if part or all of such deposit is insured under Federal law.

"(B) DOLLAR LIMITATION.—With respect to each financial institution, the aggregate amount of losses attributable to deposits in such financial institution to which an election under paragraph (1) may be made by the taxpayer for any taxable year shall not exceed $20,000 ($10,000 in the case of a separate return by a married individual). The limitation of the preceding sentence shall be reduced by the amount of any insurance proceeds under any State law which can reasonably be expected to be received with respect to losses on deposits in such institution.".

(4) Section 172(b)(1)(E)(ii), prior to amendment under title III, is amended by striking subclause (I) and by redesignating subclauses (II) and (III) as subclauses (I) and (II), respectively.

(5) Section 172(d)(4)(C) is amended by striking "paragraph (2) or (3) of section 165(c)" and inserting "section 165(c)(2)".

(6) Section 274(f) is amended by striking "CASUALTY LOSSES," in the heading thereof.

(7) Section 280A(b) is amended by striking "CASUALTY LOSSES," in the heading thereof.

(8) Section 873(b), as amended by the preceding provisions of this Act, is amended by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(9) Section 504(b) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017 is amended by adding at the end the following new paragraph:

"(4) COORDINATION WITH TAX REFORM.—This subsection shall be applied without regard to the amendments made by section 1304 of the Tax Cuts and Jobs Act.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1305. LIMITATION ON WAGERING LOSSES.

(a) IN GENERAL.—Section 165(d) is amended by adding at the end the following: "For purposes of the preceding sentence, the term 'losses from wagering transactions' includes any deduction otherwise allowable under this chapter incurred in carrying on any wagering transaction.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1306. CHARITABLE CONTRIBUTIONS.

(a) INCREASED LIMITATION FOR CASH CONTRIBUTIONS.—Section 170(b)(1) is amended by redesignating subparagraph (G) as subparagraph (H) and by inserting after subparagraph (F) the following new subparagraph:

"(G) INCREASED LIMITATION FOR CASH CONTRIBUTIONS.—

"(i) IN GENERAL.—In the case of any contribution of cash to an organization described in subparagraph (A), the total amount of such contributions which may be taken into account under subsection (a) for any taxable year shall not exceed 60 percent of the taxpayer's contribution base for such year.

"(ii) CARRYOVER.—If the aggregate amount of contributions described in clause (i) exceeds the applicable limitation under clause (i), such excess shall be treated (in a manner consistent with the rules of subsection (d)(1)) as a charitable contribution to which clause (i) applies in each of the 5 succeeding years in order of time.

"(iii) COORDINATION WITH SUBPARAGRAPHS (A) AND (B).—

"(I) IN GENERAL.—Contributions taken into account under this subparagraph shall not be taken into account under subparagraph (A).

"(II) LIMITATION REDUCTION.—Subparagraphs (A) and (B) shall be applied by reducing (but not below zero) the aggregate contribution limitation allowed for the taxable year under each such subparagraph by the aggregate contributions allowed under this subparagraph for such taxable year.".

(b) DENIAL OF DEDUCTION FOR COLLEGE ATHLETIC EVENT SEATING RIGHTS.—Section 170(l)(1) is amended to read as follows:

"(1) IN GENERAL.—No deduction shall be allowed under this section for any amount described in paragraph (2).".

(c) CHARITABLE MILEAGE RATE ADJUSTED FOR INFLATION.—Section 170(i) is amended by striking "shall be 14 cents per mile" and inserting "shall be a rate which takes into account the variable cost of operating an automobile".

(d) REPEAL OF SUBSTANTIATION EXCEPTION IN CASE OF CONTRIBUTIONS REPORTED BY DONEE.—Section 170(f)(8) is amended by striking subparagraph (D) and by redesignating subparagraph (E) as subparagraph (D).

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2017.

SEC. 1307. REPEAL OF DEDUCTION FOR TAX PREPARATION EXPENSES.

(a) IN GENERAL.—Section 212 is amended by adding "or" at the end of paragraph (1), by striking "; or" at the end of paragraph (2) and inserting a period, and by striking paragraph (3).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1308. REPEAL OF MEDICAL EXPENSE DEDUCTION.

(a) IN GENERAL.—Part VII of subchapter B is amended by striking by striking section 213 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1)(A) Section 105(f) is amended to read as follows:

"(f) MEDICAL CARE.—For purposes of this section—

"(1) IN GENERAL.—The term 'medical care' means amounts paid—

"(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,

"(B) for transportation primarily for and essential to medical care referred to in subparagraph (A),

"(C) for qualified long-term care services (as defined in section 7702B(c)), or

"(D) for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in subparagraphs (A) and (B) or for any qualified long-term care insurance contract (as defined in section 7702B(b)).

In the case of a qualified long-term care insurance contract (as defined in section 7702B(b)), only eligible long-term care premiums (as defined in paragraph (7)) shall be taken into account under subparagraph (D).

"(2) AMOUNTS PAID FOR CERTAIN LODGING AWAY FROM HOME TREATED AS PAID FOR MEDICAL CARE.—Amounts paid for lodging (not lavish or extravagant under the circumstances) while away from home primarily for and essential to medical care referred to in paragraph (1)(A) shall be treated as amounts paid for medical care if—

"(A) the medical care referred to in paragraph (1)(A) is provided by a physician in a licensed hospital (or in a medical care facility which is related to, or the equivalent of, a licensed hospital), and

"(B) there is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount taken into account under the preceding sentence shall not exceed $50 for each night for each individual.

"(3) PHYSICIAN.—The term 'physician' has the meaning given to such term by section 1861(r) of the Social Security Act (42 U.S.C. 1395x(r)).

"(4) CONTRACTS COVERING OTHER THAN MEDICAL CARE.—In the case of an insurance contract under which amounts are payable for other than medical care referred to in subparagraphs (A), (B) and (C) of paragraph (1)—

"(A) no amount shall be treated as paid for insurance to which paragraph (1)(D) applies unless the charge for such insurance is either separately stated in the contract, or furnished to the policyholder by the insurance company in a separate statement,

"(B) the amount taken into account as the amount paid for such insurance shall not exceed such charge, and

"(C) no amount shall be treated as paid for such insurance if the amount specified in the contract (or furnished to the policyholder by the insurance company in a separate statement) as the charge for such insurance is unreasonably large in relation to the total charges under the contract.

"(5) CERTAIN PRE-PAID CONTRACTS.—Subject to the limitations of paragraph (4), premiums paid during the taxable year by a taxpayer before he attains the age of 65 for insurance covering medical care (within the meaning of subparagraphs (A), (B), and (C) of paragraph (1)) for the taxpayer, his spouse, or a dependent after the taxpayer attains the age of 65 shall be treated as expenses paid during the taxable year for insurance which constitutes medical care if premiums for such insurance are payable (on a level payment basis) under the contract for a period of 10 years or more or until the year in which the taxpayer attains the age of 65 (but in no case for a period of less than 5 years).

"(6) COSMETIC SURGERY.—

"(A) IN GENERAL.—The term 'medical care' does not include cosmetic surgery or other similar procedures, unless the surgery or procedure is necessary to ameliorate a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or disfiguring disease.

"(B) COSMETIC SURGERY DEFINED .—For purposes of this paragraph, the term 'cosmetic surgery' means any procedure which is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease.

"(7) ELIGIBLE LONG-TERM CARE PREMIUMS.—

"(A) IN GENERAL.—For purposes of this section, the term 'eligible long-term care premiums' means the amount paid during a taxable year for any qualified long-term care insurance contract (as defined in section 7702B(b)) covering an individual, to the extent such amount does not exceed the limitation determined under the following table:

"In the case of an individual with an attained age before the close of the taxable year of:	The limitation is:
40 or less	$200
More than 40 but not more than 50	$375
More than 50 but not more than 60	$750
More than 60 but not more than 70	$2,000
More than 70	$2,500

"(B) INDEXING.—

"(i) IN GENERAL.—In the case of any taxable year beginning after 1997, each dollar amount in subparagraph (A) shall be increased by the medical care cost adjustment of such amount for such calendar year. Any increase determined under the preceding sentence shall be rounded to the nearest multiple of $10.

"(ii) MEDICAL CARE COST ADJUSTMENT.—For purposes of clause (i), the medical care cost adjustment for any calendar year is the adjustment prescribed by the Secretary, in consultation with the Secretary of Health and Human Services, for purposes of such clause. To the extent that CPI (as defined section 1(c)), or any component thereof, is taken into account in determining such adjustment, such adjustment shall be determined by taking into account C-CPI-U (as so defined), or the corresponding component thereof, in lieu of such CPI (or component thereof), but only with respect to the portion of such adjustment which relates to periods after December 31, 2017.

"(8) CERTAIN PAYMENTS TO RELATIVES TREATED AS NOT PAID FOR MEDICAL CARE.—An amount paid for a qualified long-term care service (as defined in section 7702B(c)) provided to an individual shall be treated as not paid for medical care if such service is provided—

"(A) by the spouse of the individual or by a relative (directly or through a partnership, corporation, or other entity) unless the service is provided by a licensed professional with respect to such service, or

"(B) by a corporation or partnership which is related (within the meaning of section 267(b) or 707(b)) to the individual.

For purposes of this paragraph, the term 'relative' means an individual bearing a relationship to the individual which is described in any of subparagraphs (A) through (G) of section 7706(d)(2). This paragraph shall not apply for purposes of subsection (b) with respect to reimbursements through insurance.".

(B) Section 72(t)(2)(D)(i)(III) is amended by striking "section 213(d)(1)(D)" and inserting "section 105(f)(1)(D)".

(C) Section 104(a) is amended by striking "section 213(d)(1)" in the last sentence and inserting "section 105(f)(1)".

(D) Section 105(b) is amended by striking "section 213(d)" and inserting "section 105(f)".

(E) Section 139D is amended by striking "section 213" and inserting "section 223".

(F) Section 162(l)(2) is amended by striking "section 213(d)(10)" and inserting "section 105(f)(7)".

(G) Section 220(d)(2)(A) is amended by striking "section 213(d)" and inserting "section 105(f)".

(H) Section 223(d)(2)(A) is amended by striking "section 213(d)" and inserting "section 105(f)".

(I) Section 419A(f)(2) is amended by striking "section 213(d)" and inserting "section 105(f)".

(J) Section 501(c)(26)(A) is amended by striking "section 213(d)" and inserting "section 105(f)".

(K) Section 2503(e) is amended by striking "section 213(d)" and inserting "section 105(f)".

(L) Section 4980B(c)(4)(B)(i)(I) is amended by striking "section 213(d)" and inserting "section 105(f)".

(M) Section 6041(f) is amended by striking "section 213(d)" and inserting "section 105(f)".

(N) Section 7702B(a)(2) is amended by striking "section 213(d)" and inserting "section 105(f)".

(O) Section 7702B(a)(4) is amended by striking "section 213(d)(1)(D)" and inserting "section 105(f)(1)(D)".

(P) Section 7702B(d)(5) is amended by striking "section 213(d)(10)" and inserting "section 105(f)(7)".

(Q) Section 9832(d)(3) is amended by striking "section 213(d)" and inserting "section 105(f)".

(2) Section 72(t)(2)(B) is amended to read as follows:

"(B) MEDICAL EXPENSES.—Distributions made to an individual (other than distributions described in subparagraph (A), (C), or (D) to the extent such distributions do not exceed the excess of—

"(i) the expenses paid by the taxpayer during the taxable year, not compensated for by insurance or otherwise, for medical care (as defined in 105(f)) of the taxpayer, his spouse, or a dependent (as defined in section 7706, determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) thereof), over

"(ii) 10 percent of the taxpayer's adjusted gross income.".

(3) Section 162(l) is amended by striking paragraph (3).

(4) Section 402(l) is amended by striking paragraph (7) and redesignating paragraph (8) as paragraph (7).

(5) Section 220(f) is amended by striking paragraph (6).

(6) Section 223(f) is amended by striking paragraph (6).

(7) Section 7702B(e) is amended by striking paragraph (2).

(8) Section 7706(f)(7), as redesignated by this Act, is amended by striking "sections 105(b), 132(h)(2)(B), and 213(d)(5)" and inserting "sections 105(b) and 132(h)(2)(B)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1309. REPEAL OF DEDUCTION FOR ALIMONY PAYMENTS.

(a) IN GENERAL.—Part VII of subchapter B is amended by striking by striking section 215 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1) CORRESPONDING REPEAL OF PROVISIONS PROVIDING FOR INCLUSION OF ALIMONY IN GROSS INCOME.—

(A) Subsection (a) of section 61 is amended by striking paragraph (8) and by redesignating paragraphs (9) through (15) as paragraphs (8) through (14), respectively.

(B) Part II of subchapter B of chapter 1 is amended by striking section 71 (and by striking the item relating to such section in the table of sections for such part).

(C) Subpart F of part I of subchapter J of chapter 1 is amended by striking section 682 (and by striking the item relating to such section in the table of sections for such subpart).

(2) RELATED TO REPEAL OF SECTION 215.—

(A) Section 62(a) is amended by striking paragraph (10).

(B) Section 3402(m)(1) is amended by striking "(other than paragraph (10) thereof)".

(3) RELATED TO REPEAL OF SECTION 71.—

(A) Section 121(d)(3) is amended—

(i) by striking "(as defined in section 71(b)(2))" in subparagraph (B), and

(ii) by adding at the end the following new subparagraph:

"(C) DIVORCE OR SEPARATION INSTRUMENT.—For purposes of this paragraph, the term 'divorce or separation instrument' means—

"(i) a decree of divorce or separate maintenance or a written instrument incident to such a decree,

"(ii) a written separation agreement, or

"(iii) a decree (not described in clause (i)) requiring a spouse to make payments for the support or maintenance of the other spouse.".

(B) Section 220(f)(7) is amended by striking "subparagraph (A) of section 71(b)(2)" and inserting "clause (i) of section 121(d)(3)(C)".

(C) Section 223(f)(7) is amended by striking "subparagraph (A) of section 71(b)(2)" and inserting "clause (i) of section 121(d)(3)(C)".

(D) Section 382(l)(3)(B)(iii) is amended by striking "section 71(b)(2)" and inserting "section 121(d)(3)(C)".

(E) Section 408(d)(6) is amended by striking "subparagraph (A) of section 71(b)(2)" and inserting "clause (i) of section 121(d)(3)(C)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to—

(1) any divorce or separation instrument (as defined in section 71(b)(2) of the Internal Revenue Code of 1986 as in effect before the date of the enactment of this Act) executed after December 31, 2017, and

(2) any divorce or separation instrument (as so defined) executed on or before such date and modified after such date if the modification expressly provides that the amendments made by this section apply to such modification.

SEC. 1310. REPEAL OF DEDUCTION FOR MOVING EXPENSES.

(a) IN GENERAL.—Part VII of subchapter B is amended by striking by striking section 217 (and by striking the item relating to such section in the table of sections for such subpart).

(b) RETENTION OF MOVING EXPENSES FOR MEMBERS OF ARMED FORCES.—Section 134(b) is amended by adding at the end the following new paragraph:

"(7) MOVING EXPENSES.—The term 'qualified military benefit' includes any benefit described in section 217(g) (as in effect before the enactment of the Tax Cuts And Jobs Act).".

(c) CONFORMING AMENDMENTS.—

(1) Section 62(a) is amended by striking paragraph (15).

(2) Section 274(m)(3) is amended by striking "(other than section 217)".

(3) Section 3121(a) is amended by striking paragraph (11).

(4) Section 3306(b) is amended by striking paragraph (9).

(5) Section 3401(a) is amended by striking paragraph (15).

(6) Section 7872(f) is amended by striking paragraph (11).

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1311. TERMINATION OF DEDUCTION AND EXCLUSIONS FOR CONTRIBUTIONS TO MEDICAL SAVINGS ACCOUNTS.

(a) TERMINATION OF INCOME TAX DEDUCTION.—Section 220 is amended by adding at the end the following new subsection:

"(k) TERMINATION.—No deduction shall be allowed under subsection (a) with respect to any taxable year beginning after December 31, 2017.".

(b) TERMINATION OF EXCLUSION FOR EMPLOYER-PROVIDED CONTRIBUTIONS.—Section 106 is amended by striking subsection (b).

(c) CONFORMING AMENDMENTS.—

(1) Section 62(a) is amended by striking paragraph (16).

(2) Section 106(d) is amended by striking paragraph (2), by redesignating paragraph (3) as paragraph (6), and by inserting after paragraph (1) the following new paragraphs:

"(2) NO CONSTRUCTIVE RECEIPT.—No amount shall be included in the gross income of any employee solely because the employee may choose between the contributions referred to in paragraph (1) and employer contributions to another health plan of the employer.

"(3) SPECIAL RULE FOR DEDUCTION OF EMPLOYER CONTRIBUTIONS.—Any employer contribution to a health savings account (as so defined), if otherwise allowable as a deduction under this chapter, shall be allowed only for the taxable year in which paid.

"(4) EMPLOYER HEALTH SAVINGS ACCOUNT CONTRIBUTION REQUIRED TO BE SHOWN ON RETURN.—Every individual required to file a return under section 6012 for the taxable year shall include on such return the aggregate amount contributed by employers to the health savings accounts (as so defined) of such individual or such individual's spouse for such taxable year.

"(5) HEALTH SAVINGS ACCOUNT CONTRIBUTIONS NOT PART OF COBRA COVERAGE.—Paragraph (1) shall not apply for purposes of section 4980B.".

(3) Section 223(b)(4) is amended by striking subparagraph (A), by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively, and by striking the second sentence thereof.

(4) Section 223(b)(5) is amended by striking "under paragraph (3))" and all that follows through "shall be divided equally between them" and inserting the following: "under paragraph (3)) shall be divided equally between the spouses".

(5) Section 223(c) is amended by striking paragraph (5).

(6) Section 3231(e) is amended by striking paragraph (10).

(7) Section 3306(b) is amended by striking paragraph (17).

(8) Section 3401(a) is amended by striking paragraph (21).

(9) Chapter 43 is amended by striking section 4980E (and by striking the item relating to such section in the table of sections for such chapter).

(10) Section 4980G is amended to read as follows:

"SEC. 4980G. FAILURE OF EMPLOYER TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS.

"(a) IN GENERAL.—In the case of an employer who makes a contribution to the health savings account of any employee during a calendar year, there is hereby imposed a tax on the failure of such employer to meet the requirements of subsection (d) for such calendar year.

"(b) AMOUNT OF TAX.—The amount of the tax imposed by subsection (a) on any failure for any calendar year is the amount equal to 35 percent of the aggregate amount contributed by the employer to health savings accounts of employees for taxable years of such employees ending with or within such calendar year.

"(c) WAIVER BY SECRETARY.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that the payment of such tax would be excessive relative to the failure involved.

"(d) EMPLOYER REQUIRED TO MAKE COMPARABLE HEALTH SAVINGS ACCOUNT CONTRIBUTIONS FOR ALL PARTICIPATING EMPLOYEES.—

"(1) IN GENERAL.—An employer meets the requirements of this subsection for any calendar year if the employer makes available comparable contributions to the health savings accounts of all comparable participating employees for each coverage period during such calendar year.

"(2) COMPARABLE CONTRIBUTIONS.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'comparable contributions' means contributions—

"(i) which are the same amount, or

"(ii) which are the same percentage of the annual deductible limit under the high deductible health plan covering the employees.

"(B) PART-YEAR EMPLOYEES.—In the case of an employee who is employed by the employer for only a portion of the calendar year, a contribution to the health savings account of such employee shall be treated as comparable if it is an amount which bears the same ratio to the comparable amount (determined without regard to this subparagraph) as such portion bears to the entire calendar year.

"(3) COMPARABLE PARTICIPATING EMPLOYEES.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'comparable participating employees' means all employees—

"(i) who are eligible individuals covered under any high deductible health plan of the employer, and

"(ii) who have the same category of coverage.

"(B) CATEGORIES OF COVERAGE.—For purposes of subparagraph (B), the categories of coverage are self-only and family coverage.

"(4) PART-TIME EMPLOYEES.—

"(A) IN GENERAL .—Paragraph (3) shall be applied separately with respect to part-time employees and other employees.

"(B) PART-TIME EMPLOYEE.—For purposes of subparagraph (A), the term 'part-time employee' means any employee who is customarily employed for fewer than 30 hours per week.

"(5) SPECIAL RULE FOR NON-HIGHLY COMPENSATED EMPLOYEES.—For purposes of applying this section to a contribution to a health savings account of an employee who is not a highly compensated employee (as defined in section 414(q)), highly compensated employees shall not be treated as comparable participating employees.

"(e) CONTROLLED GROUPS.—For purposes of this section, all persons treated as a single employer under subsection (b), (c), (m), or (o) of section 414 shall be treated as 1 employer.

"(f) DEFINITIONS.—Terms used in this section which are also used in section 223 have the respective meanings given such terms in section 223.

"(g) REGULATIONS.—The Secretary shall issue regulations to carry out the purposes of this section.".

(11) Section 6051(a) is amended by striking paragraph (11).

(12) Section 6051(a)(14)(A) is amended by striking "paragraphs (11) and (12)" and inserting "paragraph (12)".

(d) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1312. DENIAL OF DEDUCTION FOR EXPENSES ATTRIBUTABLE TO THE TRADE OR BUSINESS OF BEING AN EMPLOYEE.

(a) IN GENERAL.—Part IX of subchapter B of chapter 1 is amended by inserting after the item relating to section 262 the following new item:

"SEC. 262A. EXPENSES ATTRIBUTABLE TO BEING AN EMPLOYEE.

"(a) IN GENERAL.—Except as otherwise provided in this section, no deduction shall be allowed with respect to any trade or business of the taxpayer which consists of the performance of services by the taxpayer as an employee.

"(b) EXCEPTION FOR ABOVE-THE-LINE DEDUCTIONS.—Subsection (a) shall not apply to any deduction allowable (determined without regard to subsection (a)) in determining adjusted gross income.".

(b) REPEAL OF CERTAIN ABOVE-THE-LINE TRADE AND BUSINESS DEDUCTIONS OF EMPLOYEES.—

(1) IN GENERAL.—Section 62(a)(2) is amended—

(A) by striking subparagraphs (B), (C), and (D), and

(B) by redesignating subparagraph (E) as subparagraph (B).

(2) CONFORMING AMENDMENTS.—

(A) Section 62 is amended by striking subsections (b) and (d) and by redesignating subsections (c) and (e) as subsections (b) and (c), respectively.

(B) Section 62(a)(20) is amended by striking "subsection (e)" and inserting "subsection (c)".

(c) CONTINUED EXCLUSION OF WORKING CONDITION FRINGE BENEFITS.—Section 132(d) is amended by inserting "(determined without regard to section 262A)" after "section 162".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle E—Simplification and Reform of Exclusions and Taxable Compensation

SEC. 1401. LIMITATION ON EXCLUSION FOR EMPLOYER-PROVIDED HOUSING.

(a) IN GENERAL.—Section 119 is amended by adding at the end the following new subsection:

"(e) LIMITATION ON EXCLUSION OF LODGING.—

"(1) IN GENERAL.—The aggregate amount excluded from gross income of the taxpayer under subsections (a) and (d) with respect to lodging for any taxable year shall not exceed $50,000 (half such amount in the case of a married individual filing a separate return).

"(2) LIMITATION TO 1 HOME.—Subsections (a) and (d) (separately and in combination) shall not apply with respect to more than 1 residence of the taxpayer at any given time. In the case of a joint return, the preceding sentence shall apply separately to each spouse for any period during which each spouse resides separate from the other spouse in a residence which is provided in connection with the employment of each spouse, respectively.

"(3) LIMITATION FOR HIGHLY COMPENSATED EMPLOYEES.—

"(A) REDUCED FOR EXCESS COMPENSATION.—In the case of an individual whose compensation for the taxable year exceeds the amount in effect under section 414(q)(1)(B)(i) for the calendar in which such taxable year begins, the $50,000 amount under paragraph (1) shall be reduced (but not below zero) by an amount equal to 50 percent of such excess. For purposes of the preceding sentence, the term 'compensation' means wages (as defined in section 3121(a) (without regard to the contribution and benefit base limitation in section 3121(a)(1)).

"(B) EXCLUSION DENIED FOR 5-PERCENT OWNERS.—In the case of an individual who is a 5-percent owner (as defined in section 416(i)(1)(B)(i)) of the employer at any time during the taxable year, the amount under paragraph (1) shall be zero.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1402. EXCLUSION OF GAIN FROM SALE OF A PRINCIPAL RESIDENCE.

(a) REQUIREMENT THAT RESIDENCE BE PRINCIPAL RESIDENCE FOR 5 YEARS DURING 8-YEAR PERIOD.—Subsection (a) of section 121 is amended—

(1) by striking "5-year period" and inserting "8-year period", and

(2) by striking "2 years" and inserting "5 years".

(b) APPLICATION TO ONLY 1 SALE OR EXCHANGE EVERY 5 YEARS.—Paragraph (3) of section 121(b) is amended to read as follows:

"(3) APPLICATION TO ONLY 1 SALE OR EXCHANGE EVERY 5 YEARS.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 5-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.".

(c) PHASEOUT BASED ON MODIFIED ADJUSTED GROSS INCOME.—Section 121 is amended by adding at the end the following new subsection:

"(h) PHASEOUT BASED ON MODIFIED ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—If the average modified adjusted gross income of the taxpayer for the taxable year and the 2 preceding taxable years exceeds $250,000 (twice such amount in the case of a joint return), the amount which would (but for this subsection) be excluded from gross income under subsection (a) for such taxable year shall be reduced (but not below zero) by the amount of such excess.

"(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means, with respect to any taxable year, adjusted gross income determined after application of this section (but without regard to subsection (b)(1) and this subsection).

"(3) SPECIAL RULE FOR JOINT RETURNS.—In the case of a joint return, the average modified adjusted gross income of the taxpayer shall be determined without regard to any taxable year with respect to which the taxpayer did not file a joint return.".

(d) CONFORMING AMENDMENTS.—

(1) The following provisions of section 121 are each amended by striking "5-year period" each place it appears therein and inserting "8-year period":

(A) Subsection (b)(5)(C)(ii)(I).

(B) Subsection (c)(1)(B)(i)(I).

(C) Subsection (d)(7)(B).

(D) Subparagraphs (A) and (B) of subsection (d)(9).

(E) Subsection (d)(10).

(F) Subsection (d)(12)(A).

(2) Section 121(c)(1)(B)(ii) is amended by striking "2 years" and inserting "5 years":

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to sales and exchanges after December 31, 2017.

SEC. 1403. REPEAL OF EXCLUSION, ETC., FOR EMPLOYEE ACHIEVEMENT AWARDS.

(a) IN GENERAL.—Section 74 is amended by striking subsection (c).

(b) REPEAL OF LIMITATION ON DEDUCTION.—Section 274 is amended by striking subsection (j).

(c) CONFORMING AMENDMENTS.—

(1) Section 102(c)(2) is amended by striking the first sentence.

(2) Section 414(n)(3)(C) is amended by striking "274(j),".

(3) Section 414(t)(2) is amended by striking "274(j),".

(4) Section 3121(a)(20) is amended by striking "74(c)".

(5) Section 3231(e)(5) is amended by striking "74(c),".

(6) Section 3306(b)(16) is amended by striking "74(c),".

(7) Section 3401(a)(19) is amended by striking "74(c),".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1404. SUNSET OF EXCLUSION FOR DEPENDENT CARE ASSISTANCE PROGRAMS.

(a) IN GENERAL.—Section 129 is amended by adding at the end the following new subsection:

"(f) TERMINATION.—Subsection (a) shall not apply to taxable years beginning after December 31, 2022.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 1405. REPEAL OF EXCLUSION FOR QUALIFIED MOVING EXPENSE REIMBURSEMENT.

(a) IN GENERAL.—Section 132(a) is amended by striking paragraph (6).

(b) CONFORMING AMENDMENTS.—

(1) Section 82 is amended by striking "Except as provided in section 132(a)(6), there" and inserting "There".

(2) Section 132 is amended by striking subsection (g).

(3) Section 132(l) is amended by striking by striking "subsections (e) and (g)" and inserting "subsection (e)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1406. REPEAL OF EXCLUSION FOR ADOPTION ASSISTANCE PROGRAMS.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 is amended by striking section 137 (and by striking the item relating to such section in the table of sections for such part).

(b) CONFORMING AMENDMENTS.—

(1) Sections 414(n)(3)(C), 414(t)(2), 74(d)(2)(B), 86(b)(2)(A), 219(g)(3)(A)(ii) are each amended by striking ", 137".

(2) Section 1016(a), as amended by the preceding provision of this Act, is amended by striking paragraph (26).

(3) Section 6039D(d)(1), as amended by the preceding provisions of this Act, is amended—

(A) by striking ", or 137", and

(B) by inserting "or" before "125".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

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.

(a) IN GENERAL.—Section 408A(d) is amended by striking paragraph (6) and by redesignating paragraph (7) as paragraph (6).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1502. REDUCTION IN MINIMUM AGE FOR ALLOWABLE IN-SERVICE DISTRIBUTIONS.

(a) IN GENERAL.—Section 401(a)(36) is amended by striking "age 62" and inserting "age 59 ½".

(b) APPLICATION TO GOVERNMENTAL SECTION 457(b) PLANS.—Clause (i) of section 457(d)(1)(A) is amended by inserting "(in the case of a plan maintained by an employer described in subsection (e)(1)(A), age 59 ½)" before the comma at the end.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2017.

SEC. 1503. MODIFICATION OF RULES GOVERNING HARDSHIP DISTRIBUTIONS.

(a) IN GENERAL.—Not later than 1 year after the date of the enactment of this Act, the Secretary of the Treasury shall modify Treasury Regulation section 1.401(k)–1(d)(3)(iv)(E) to—

(1) delete the 6-month prohibition on contributions imposed by paragraph (2) thereof, and

(2) make any other modifications necessary to carry out the purposes of section 401(k)(2)(B)(i)(IV) of the Internal Revenue Code of 1986.

(b) EFFECTIVE DATE.—The revised regulations under this section shall apply to plan years beginning after December 31, 2017.

SEC. 1504. MODIFICATION OF RULES RELATING TO HARDSHIP WITHDRAWALS FROM CASH OR DEFERRED ARRANGEMENTS.

(a) IN GENERAL.—Section 401(k) is amended by adding at the end the following:

"(14) SPECIAL RULES RELATING TO HARDSHIP WITHDRAWALS.—For purposes of paragraph (2)(B)(i)(IV)—

"(A) AMOUNTS WHICH MAY BE WITHDRAWN.—The following amounts may be distributed upon hardship of the employee:

"(i) Contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies.

"(ii) Qualified nonelective contributions (as defined in subsection (m)(4)(C)).

"(iii) Qualified matching contributions described in paragraph (3)(D)(ii)(I).

"(iv) Earnings on any contributions described in clause (i), (ii), or (iii).

"(B) NO REQUIREMENT TO TAKE AVAILABLE LOAN.—A distribution shall not be treated as failing to be made upon the hardship of an employee solely because the employee does not take any available loan under the plan.".

(b) CONFORMING AMENDMENT.—Section 401(k)(2)(B)(i)(IV) is amended to read as follows:

"(IV) subject to the provisions of paragraph (14), upon hardship of the employee, or".".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2017.

SEC. 1505. EXTENDED ROLLOVER PERIOD FOR THE ROLLOVER OF PLAN LOAN OFFSET AMOUNTS IN CERTAIN CASES.

(a) IN GENERAL.—Paragraph (3) of section 402(c) is amended by adding at the end the following new subparagraph:

"(C) ROLLOVER OF CERTAIN PLAN LOAN OFFSET AMOUNTS.—

"(i) IN GENERAL.—In the case of a qualified plan loan offset amount, paragraph (1) shall not apply to any transfer of such amount made after the due date (including extensions) for filing the return of tax for the taxable year in which such amount is treated as distributed from a qualified employer plan.

"(ii) QUALIFIED PLAN LOAN OFFSET AMOUNT.—For purposes of this subparagraph, the term 'qualified plan loan offset amount' means a plan loan offset amount which is treated as distributed from a qualified employer plan to a participant or beneficiary solely by reason of—

"(I) the termination of the qualified employer plan, or

"(II) the failure to meet the repayment terms of the loan from such plan because of the separation from service of the participant (whether due to layoff, cessation of business, termination of employment, or otherwise).

"(iii) PLAN LOAN OFFSET AMOUNT.—For purposes of clause (ii), the term 'plan loan offset amount' means the amount by which the participant's accrued benefit under the plan is reduced in order to repay a loan from the plan.

"(iv) LIMITATION.—This subparagraph shall not apply to any plan loan offset amount unless such plan loan offset amount relates to a loan to which section 72(p)(1) does not apply by reason of section 72(p)(2).

"(v) QUALIFIED EMPLOYER PLAN.—For purposes of this subsection, the term 'qualified employer plan' has the meaning given such term by section 72(p)(4).".

(b) CONFORMING AMENDMENT.—Subparagraph (A) of section 402(c)(3) is amended by striking "subparagraph (B)" and inserting "subparagraphs (B) and (C)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 1506. MODIFICATION OF NONDISCRIMINATION RULES TO PROTECT OLDER, LONGER SERVICE PARTICIPANTS.

(a) IN GENERAL.—Section 401 is amended—

(1) by redesignating subsection (o) as subsection (p), and

(2) by inserting after subsection (n) the following new subsection:

"(o) SPECIAL RULES FOR APPLYING NONDISCRIMINATION RULES TO PROTECT OLDER, LONGER SERVICE AND GRANDFATHERED PARTICIPANTS.—

"(1) TESTING OF DEFINED BENEFIT PLANS WITH CLOSED CLASSES OF PARTICIPANTS.—

"(A) BENEFITS, RIGHTS, OR FEATURES PROVIDED TO CLOSED CLASSES.—A defined benefit plan which provides benefits, rights, or features to a closed class of participants shall not fail to satisfy the requirements of subsection (a)(4) by reason of the composition of such closed class or the benefits, rights, or features provided to such closed class, if—

"(i) for the plan year as of which the class closes and the 2 succeeding plan years, such benefits, rights, and features satisfy the requirements of subsection (a)(4) (without regard to this subparagraph but taking into account the rules of subparagraph (I)),

"(ii) after the date as of which the class was closed, any plan amendment which modifies the closed class or the benefits, rights, and features provided to such closed class does not discriminate significantly in favor of highly compensated employees, and

"(iii) the class was closed before April 5, 2017, or the plan is described in subparagraph (C).

"(B) AGGREGATE TESTING WITH DEFINED CONTRIBUTION PLANS PERMITTED ON A BENEFITS BASIS.—

"(i) IN GENERAL.—For purposes of determining compliance with subsection (a)(4) and section 410(b), a defined benefit plan described in clause (iii) may be aggregated and tested on a benefits basis with 1 or more defined contribution plans, including with the portion of 1 or more defined contribution plans which—

"(I) provides matching contributions (as defined in subsection (m)(4)(A)),

"(II) provides annuity contracts described in section 403(b) which are purchased with matching contributions or nonelective contributions, or

"(III) consists of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a tax credit employee stock ownership plan (within the meaning of section 409(a)).

"(ii) SPECIAL RULES FOR MATCHING CONTRIBUTIONS.—For purposes of clause (i), if a defined benefit plan is aggregated with a portion of a defined contribution plan providing matching contributions—

"(I) such defined benefit plan must also be aggregated with any portion of such defined contribution plan which provides elective deferrals described in subparagraph (A) or (C) of section 402(g)(3), and

"(II) such matching contributions shall be treated in the same manner as nonelective contributions, including for purposes of applying the rules of subsection (l).

"(iii) PLANS DESCRIBED.—A defined benefit plan is described in this clause if—

"(I) the plan provides benefits to a closed class of participants,

"(II) for the plan year as of which the class closes and the 2 succeeding plan years, the plan satisfies the requirements of section 410(b) and subsection (a)(4) (without regard to this subparagraph but taking into account the rules of subparagraph (I)),

"(III) after the date as of which the class was closed, any plan amendment which modifies the closed class or the benefits provided to such closed class does not discriminate significantly in favor of highly compensated employees, and

"(IV) the class was closed before April 5, 2017, or the plan is described in subparagraph (C).

"(C) PLANS DESCRIBED.—A plan is described in this subparagraph if, taking into account any predecessor plan—

"(i) such plan has been in effect for at least 5 years as of the date the class is closed, and

"(ii) during the 5-year period preceding the date the class is closed, there has not been a substantial increase in the coverage or value of the benefits, rights, or features described in subparagraph (A) or in the coverage or benefits under the plan described in subparagraph (B)(iii) (whichever is applicable).

"(D) DETERMINATION OF SUBSTANTIAL INCREASE FOR BENEFITS, RIGHTS, AND FEATURES.—In applying subparagraph (C)(ii) for purposes of subparagraph (A)(iii), a plan shall be treated as having had a substantial increase in coverage or value of the benefits, rights, or features described in subparagraph (A) during the applicable 5-year period only if, during such period—

"(i) the number of participants covered by such benefits, rights, or features on the date such period ends is more than 50 percent greater than the number of such participants on the first day of the plan year in which such period began, or

"(ii) such benefits, rights, and features have been modified by 1 or more plan amendments in such a way that, as of the date the class is closed, the value of such benefits, rights, and features to the closed class as a whole is substantially greater than the value as of the first day of such 5-year period, solely as a result of such amendments.

"(E) DETERMINATION OF SUBSTANTIAL INCREASE FOR AGGREGATE TESTING ON BENEFITS BASIS.—In applying subparagraph (C)(ii) for purposes of subparagraph (B)(iii)(IV), a plan shall be treated as having had a substantial increase in coverage or benefits during the applicable 5-year period only if, during such period—

"(i) the number of participants benefitting under the plan on the date such period ends is more than 50 percent greater than the number of such participants on the first day of the plan year in which such period began, or

"(ii) the average benefit provided to such participants on the date such period ends is more than 50 percent greater than the average benefit provided on the first day of the plan year in which such period began.

"(F) CERTAIN EMPLOYEES DISREGARDED.—For purposes of subparagraphs (D) and (E), any increase in coverage or value or in coverage or benefits, whichever is applicable, which is attributable to such coverage and value or coverage and benefits provided to employees—

"(i) who became participants as a result of a merger, acquisition, or similar event which occurred during the 7-year period preceding the date the class is closed, or

"(ii) who became participants by reason of a merger of the plan with another plan which had been in effect for at least 5 years as of the date of the merger,

shall be disregarded, except that clause (ii) shall apply for purposes of subparagraph (D) only if, under the merger, the benefits, rights, or features under 1 plan are conformed to the benefits, rights, or features of the other plan prospectively.

"(G) RULES RELATING TO AVERAGE BENEFIT.—For purposes of subparagraph (E)—

"(i) the average benefit provided to participants under the plan will be treated as having remained the same between the 2 dates described in subparagraph (E)(ii) if the benefit formula applicable to such participants has not changed between such dates, and

"(ii) if the benefit formula applicable to 1 or more participants under the plan has changed between such 2 dates, then the average benefit under the plan shall be considered to have increased by more than 50 percent only if—

"(I) the total amount determined under section 430(b)(1)(A)(i) for all participants benefitting under the plan for the plan year in which the 5-year period described in subparagraph (E) ends, exceeds

"(II) the total amount determined under section 430(b)(1)(A)(i) for all such participants for such plan year, by using the benefit formula in effect for each such participant for the first plan year in such 5-year period, by more than 50 percent.

In the case of a CSEC plan (as defined in section 414(y)), the normal cost of the plan (as determined under section 433(j)(1)(B)) shall be used in lieu of the amount determined under section 430(b)(1)(A)(i).

"(H) TREATMENT AS SINGLE PLAN.—For purposes of subparagraphs (E) and (G), a plan described in section 413(c) shall be treated as a single plan rather than as separate plans maintained by each participating employer.

"(I) SPECIAL RULES.—For purposes of subparagraphs (A)(i) and (B)(iii)(II), the following rules shall apply:

"(i) In applying section 410(b)(6)(C), the closing of the class of participants shall not be treated as a significant change in coverage under section 410(b)(6)(C)(i)(II).

"(ii) 2 or more plans shall not fail to be eligible to be aggregated and treated as a single plan solely by reason of having different plan years.

"(iii) Changes in the employee population shall be disregarded to the extent attributable to individuals who become employees or cease to be employees, after the date the class is closed, by reason of a merger, acquisition, divestiture, or similar event.

"(iv) Aggregation and all other testing methodologies otherwise applicable under subsection (a)(4) and section 410(b) may be taken into account.

The rule of clause (ii) shall also apply for purposes of determining whether plans to which subparagraph (B)(i) applies may be aggregated and treated as 1 plan for purposes of determining whether such plans meet the requirements of subsection (a)(4) and section 410(b).

"(J) SPUN-OFF PLANS.—For purposes of this paragraph, if a portion of a defined benefit plan described in subparagraph (A) or (B)(iii) is spun off to another employer and the spun-off plan continues to satisfy the requirements of—

"(i) subparagraph (A)(i) or (B)(iii)(II), whichever is applicable, if the original plan was still within the 3-year period described in such subparagraph at the time of the spin off, and

"(ii) subparagraph (A)(ii) or (B)(iii)(III), whichever is applicable,

the treatment under subparagraph (A) or (B) of the spun-off plan shall continue with respect to such other employer.

"(2) TESTING OF DEFINED CONTRIBUTION PLANS.—

"(A) TESTING ON A BENEFITS BASIS.—A defined contribution plan shall be permitted to be tested on a benefits basis if—

"(i) such defined contribution plan provides make-whole contributions to a closed class of participants whose accruals under a defined benefit plan have been reduced or eliminated,

"(ii) for the plan year of the defined contribution plan as of which the class eligible to receive such make-whole contributions closes and the 2 succeeding plan years, such closed class of participants satisfies the requirements of section 410(b)(2)(A)(i) (determined by applying the rules of paragraph (1)(I)),

"(iii) after the date as of which the class was closed, any plan amendment to the defined contribution plan which modifies the closed class or the allocations, benefits, rights, and features provided to such closed class does not discriminate significantly in favor of highly compensated employees, and

"(iv) the class was closed before April 5, 2017, or the defined benefit plan under clause (i) is described in paragraph (1)(C) (as applied for purposes of paragraph (1)(B)(iii)(IV)).

"(B) AGGREGATION WITH PLANS INCLUDING MATCHING CONTRIBUTIONS.—

"(i) IN GENERAL.—With respect to 1 or more defined contribution plans described in subparagraph (A), for purposes of determining compliance with subsection (a)(4) and section 410(b), the portion of such plans which provides make-whole contributions or other nonelective contributions may be aggregated and tested on a benefits basis with the portion of 1 or more other defined contribution plans which—

"(I) provides matching contributions (as defined in subsection (m)(4)(A)),

"(II) provides annuity contracts described in section 403(b) which are purchased with matching contributions or nonelective contributions, or

"(III) consists of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a tax credit employee stock ownership plan (within the meaning of section 409(a)).

"(ii) SPECIAL RULES FOR MATCHING CONTRIBUTIONS.—Rules similar to the rules of paragraph (1)(B)(ii) shall apply for purposes of clause (i).

"(C) SPECIAL RULES FOR TESTING DEFINED CONTRIBUTION PLAN FEATURES PROVIDING MATCHING CONTRIBUTIONS TO CERTAIN OLDER, LONGER SERVICE PARTICIPANTS.—In the case of a defined contribution plan which provides benefits, rights, or features to a closed class of participants whose accruals under a defined benefit plan have been reduced or eliminated, the plan shall not fail to satisfy the requirements of subsection (a)(4) solely by reason of the composition of the closed class or the benefits, rights, or features provided to such closed class if the defined contribution plan and defined benefit plan otherwise meet the requirements of subparagraph (A) but for the fact that the make-whole contributions under the defined contribution plan are made in whole or in part through matching contributions.

"(D) SPUN-OFF PLANS.—For purposes of this paragraph, if a portion of a defined contribution plan described in subparagraph (A) or (C) is spun off to another employer, the treatment under subparagraph (A) or (C) of the spun-off plan shall continue with respect to the other employer if such plan continues to comply with the requirements of clauses (ii) (if the original plan was still within the 3-year period described in such clause at the time of the spin off) and (iii) of subparagraph (A), as determined for purposes of subparagraph (A) or (C), whichever is applicable.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) MAKE-WHOLE CONTRIBUTIONS.—Except as otherwise provided in paragraph (2)(C), the term 'make-whole contributions' means nonelective allocations for each employee in the class which are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits which the employee would have received under the defined benefit plan and any other plan or qualified cash or deferred arrangement under subsection (k)(2) if no change had been made to such defined benefit plan and such other plan or arrangement. For purposes of the preceding sentence, consistency shall not be required with respect to employees who were subject to different benefit formulas under the defined benefit plan.

"(B) REFERENCES TO CLOSED CLASS OF PARTICIPANTS.—References to a closed class of participants and similar references to a closed class shall include arrangements under which 1 or more classes of participants are closed, except that 1 or more classes of participants closed on different dates shall not be aggregated for purposes of determining the date any such class was closed.

"(C) HIGHLY COMPENSATED EMPLOYEE.—The term 'highly compensated employee' has the meaning given such term in section 414(q).".".

(b) PARTICIPATION REQUIREMENTS.—Paragraph (26) of section 401(a) is amended by adding at the end the following new subparagraph:

"(I) PROTECTED PARTICIPANTS.—

"(i) IN GENERAL.—A plan shall be deemed to satisfy the requirements of subparagraph (A) if—

"(I) the plan is amended—

"(aa) to cease all benefit accruals, or

"(bb) to provide future benefit accruals only to a closed class of participants,

"(II) the plan satisfies subparagraph (A) (without regard to this subparagraph) as of the effective date of the amendment, and

"(III) the amendment was adopted before April 5, 2017, or the plan is described in clause (ii).

"(ii) PLANS DESCRIBED.—A plan is described in this clause if the plan would be described in subsection (o)(1)(C), as applied for purposes of subsection (o)(1)(B)(iii)(IV) and by treating the effective date of the amendment as the date the class was closed for purposes of subsection (o)(1)(C).

"(iii) SPECIAL RULES.—For purposes of clause (i)(II), in applying section 410(b)(6)(C), the amendments described in clause (i) shall not be treated as a significant change in coverage under section 410(b)(6)(C)(i)(II).

"(iv) SPUN-OFF PLANS.—For purposes of this subparagraph, if a portion of a plan described in clause (i) is spun off to another employer, the treatment under clause (i) of the spun-off plan shall continue with respect to the other employer.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall take effect on the date of the enactment of this Act, without regard to whether any plan modifications referred to in such amendments are adopted or effective before, on, or after such date of enactment.

(2) SPECIAL RULES.—

(A) ELECTION OF EARLIER APPLICATION.—At the election of the plan sponsor, the amendments made by this section shall apply to plan years beginning after December 31, 2013.

(B) CLOSED CLASSES OF PARTICIPANTS.—For purposes of paragraphs (1)(A)(iii), (1)(B)(iii)(IV), and (2)(A)(iv) of section 401(o) of the Internal Revenue Code of 1986 (as added by this section), a closed class of participants shall be treated as being closed before April 5, 2017, if the plan sponsor's intention to create such closed class is reflected in formal written documents and communicated to participants before such date.

(C) CERTAIN POST-ENACTMENT PLAN AMENDMENTS.—A plan shall not be treated as failing to be eligible for the application of section 401(o)(1)(A), 401(o)(1)(B)(iii), or 401(a)(26) of such Code (as added by this section) to such plan solely because in the case of—

(i) such section 401(o)(1)(A), the plan was amended before the date of the enactment of this Act to eliminate 1 or more benefits, rights, or features, and is further amended after such date of enactment to provide such previously eliminated benefits, rights, or features to a closed class of participants, or

(ii) such section 401(o)(1)(B)(iii) or section 401(a)(26), the plan was amended before the date of the enactment of this Act to cease all benefit accruals, and is further amended after such date of enactment to provide benefit accruals to a closed class of participants. Any such section shall only apply if the plan otherwise meets the requirements of such section and in applying such section, the date the class of participants is closed shall be the effective date of the later amendment.

Subtitle G—Estate, Gift, and Generation-skipping Transfer Taxes

SEC. 1601. INCREASE IN CREDIT AGAINST ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX.

(a) IN GENERAL.—Section 2010(c)(3) is amended by striking "$5,000,000" and inserting "$10,000,000".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying, generation-skipping transfers, and gifts made, after December 31, 2017.

SEC. 1602. REPEAL OF ESTATE AND GENERATION-SKIPPING TRANSFER TAXES.

(a) ESTATE TAX REPEAL.—

(1) IN GENERAL.—Subchapter C of chapter 11 is amended by adding at the end the following new section:

"SEC. 2210. TERMINATION.

"(a) IN GENERAL.—Except as provided in subsection (b), this chapter shall not apply to the estates of decedents dying after December 31, 2024.

"(b) CERTAIN DISTRIBUTIONS FROM QUALIFIED DOMESTIC TRUSTS.—In applying section 2056A with respect to the surviving spouse of a decedent dying on or before December 31, 2024—

"(1) section 2056A(b)(1)(A) shall not apply to distributions made after the 10-year period beginning on such date, and

"(2) section 2056A(b)(1)(B) shall not apply after such date.".

(2) CONFORMING AMENDMENTS.—Section 1014(b) is amended—

(A) in paragraph (6), by striking "was includible in determining" and all that follows through the end and inserting "was includible (or would have been includible without regard to section 2210) in determining the value of the decedent's gross estate under chapter 11 of subtitle B" ,

(B) in paragraph (9), by striking "required to be included" through "Code of 1939" and inserting "required to be included (or would have been required to be included without regard to section 2210) in determining the value of the decedent's gross estate under chapter 11 of subtitle B", and

(C) in paragraph (10), by striking "Property includible in the gross estate" and inserting "Property includible (or which would have been includible without regard to section 2210) in the gross estate".

(3) CLERICAL AMENDMENT.—The table of sections for subchapter C of chapter 11 is amended by adding at the end the following new item:

"Sec. 2210. Termination.".

(b) GENERATION-SKIPPING TRANSFER TAX REPEAL.—

(1) IN GENERAL.—Subchapter G of chapter 13 of subtitle B of such Code is amended by adding at the end the following new section:

"SEC. 2664. TERMINATION.

"This chapter shall not apply to generation-skipping transfers after December 31, 2024.".

(2) CLERICAL AMENDMENT.—The table of sections for subchapter G of chapter 13 of such Code is amended by adding at the end the following new item:

"Sec. 2664. Termination.".

(c) CONFORMING AMENDMENTS RELATED TO GIFT TAX.—

(1) COMPUTATION OF GIFT TAX.—Section 2502 is amended by adding at the end the following new subsection:

"(d) GIFTS MADE AFTER 2024.—

"(1) IN GENERAL.—In the case of a gift made after December 31, 2024, subsection (a) shall be applied by substituting 'subsection (d)(2)' for 'section 2001(c)' and 'such subsection' for 'such section'.

"(2) RATE SCHEDULE.—

"If the amount with respect to which the tentative tax to be computed is:.	**The tentative tax is:**
Not over $10,000	18% of such amount.
Over $10,000 but not over $20,000	$1,800, plus 20% of the excess over $10,000.
Over $20,000 but not over $40,000	$3,800, plus 22% of the excess over $20,000.

Over $40,000 but not over $60,000	$8,200, plus 24% of the excess over $40,000.
Over $60,000 but not over $80,000	$13,000, plus 26% of the excess over $60,000.
Over $80,000 but not over $100,000	$18,200, plus 28% of the excess over $80,000.
Over $100,000 but not over $150,000	$23,800, plus 30% of the excess over $100,000.
Over $150,000 but not over $250,000	$38,800, plus 32% of the excess of $150,000.
Over $250,000 but not over $500,000	$70,800, plus 34% of the excess over $250,000.
Over $500,000	$155,800, plus 35% of the excess of $500,000.”.

(2) LIFETIME GIFT EXEMPTION.—Section 2505 is amended by adding at the end the following new subsection:

“(d) GIFTS MADE AFTER 2024.—

“(1) IN GENERAL.—In the case of a gift made after December 31, 2024, subsection (a)(1) shall be applied by substituting ‘the amount of the tentative tax which would be determined under the rate schedule set forth in section 2502(a)(2) if the amount with respect to which such tentative tax is to be computed were $10,000,000’ for ‘the applicable credit amount in effect under section 2010(c) which would apply if the donor died as of the end of the calendar year’.

“(2) INFLATION ADJUSTMENT.—

“(A) IN GENERAL.—In the case of any calendar year after 2024, the dollar amount in subsection (a)(1) (after application of this subsection) shall be increased by an amount equal to—

“(i) such dollar amount, multiplied by

“(ii) the cost-of-living adjustment determined under section 1(c)(2)(A) of such calendar year by substituting ‘calendar year 2011’ for ‘calendar year 2016’ in clause (ii) thereof.

“(B) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.”.

(3) OTHER CONFORMING AMENDMENTS RELATED TO GIFT TAX.—Section 2801 is amended by adding at the end the following new subsection:

“(g) GIFTS RECEIVED AFTER 2024.—In the case of a gift received after December 31, 2024, subsection (a)(1) shall be applied by substituting ‘section 2502(a)(2)’ for ‘section 2001(c) as in effect on the date of such receipt’.”.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying, generation-skipping transfers, and gifts made, after December 31, 2024.

TITLE II—ALTERNATIVE MINIMUM TAX REPEAL

SEC. 2001. REPEAL OF ALTERNATIVE MINIMUM TAX.

(a) IN GENERAL.—Subchapter A of chapter 1 is amended by striking part VI (and by striking the item relating to such part in the table of parts for subchapter A).

(b) CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—

(1) LIMITATION.—Subsection (c) of section 53 is amended to read as follows:

“(c) LIMITATION.—The credit allowable under subsection (a) shall not exceed the regular tax liability of the taxpayer reduced by the sum of the credits allowed under subparts A, B, and D.”.

(2) CREDITS TREATED AS REFUNDABLE.—Section 53 is amended by adding at the end the following new subsection:

“(e) PORTION OF CREDIT TREATED AS REFUNDABLE.—

“(1) IN GENERAL.—In the case of any taxable year beginning in 2019, 2020, 2021, or 2022, the limitation under subsection (c) shall be increased by the AMT refundable credit amount for such year.

“(2) AMT REFUNDABLE CREDIT AMOUNT.—For purposes of paragraph (1), the AMT refundable credit amount is an amount equal to 50 percent (100 percent in the case of a taxable year beginning in 2022) of the excess (if any) of—

“(A) the minimum tax credit determined under subsection (b) for the taxable year, over

“(B) the minimum tax credit allowed under subsection (a) for such year (before the application of this subsection for such year).

"(3) CREDIT REFUNDABLE.—For purposes of this title (other than this section), the credit allowed by reason of this subsection shall be treated as a credit allowed under subpart C (and not this subpart).

"(4) SHORT TAXABLE YEARS.—In the case of any taxable year of less than 365 days, the AMT refundable credit amount determined under paragraph (2) with respect to such taxable year shall be the amount which bears the same ratio to such amount determined without regard to this paragraph as the number of days in such taxable year bears to 365.".

(3) TREATMENT OF REFERENCES.—Section 53(d) is amended by adding at the end the following new paragraph:

"(3) AMT TERM REFERENCES.—Any references in this subsection to section 55, 56, or 57 shall be treated as a reference to such section as in effect before its repeal by the Tax Cuts and Jobs Act.".

(c) CONFORMING AMENDMENTS RELATED TO AMT REPEAL.—

(1) Section 2(d) is amended by striking "sections 1 and 55" and inserting "section 1".

(2) Section 5(a) is amended by striking paragraph (4).

(3) Section 11(d) is amended by striking "the taxes imposed by subsection (a) and section 55" and inserting "the tax imposed by subsection (a)".

(4) Section 12 is amended by striking paragraph (7).

(5) Section 26(a) is amended to read as follows:

"(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the taxpayer's regular tax liability for the taxable year.".

(6) Section 26(b)(2) is amended by striking subparagraph (A).

(7) Section 26 is amended by striking subsection (c).

(8) Section 38(c) is amended—

(A) by striking paragraphs (1) through (5),

(B) by redesignating paragraph (6) as paragraph (2),

(C) by inserting before paragraph (2) (as so redesignated) the following new paragraph:

"(1) IN GENERAL.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess (if any) of—

"(A) the sum of—

"(i) so much of the regular tax liability as does not exceed $25,000, plus

"(ii) 75 percent of so much of the regular tax liability as exceeds $25,000, over

"(B) the sum of the credits allowable under subparts A and B of this part.", and

(D) by striking "subparagraph (B) of paragraph (1)" each place it appears in paragraph (2) (as so redesignated) and inserting "clauses (i) and (ii) of paragraph (1)(A)".

(9) Section 39(a) is amended—

(A) by striking "or the eligible small business credits" in paragraph (3)(A), and

(B) by striking paragraph (4).

(10) Section 45D(g)(4)(B) is amended by striking "or for purposes of section 55".

(11) Section 54(c)(1) is amended to read as follows:

"(1) regular tax liability (as defined in section 26(b)), over".

(12) Section 54A(c)(1)(A) is amended to read as follows:

"(A) regular tax liability (as defined in section 26(b)), over".

(13) Section 148(b)(3) is amended to read as follows:

"(3) TAX-EXEMPT BONDS NOT TREATED AS INVESTMENT PROPERTY.—The term 'investment property' does not include any tax-exempt bond.".

(14) Section 168(k)(2) is amended by striking subparagraph (G).

(15) Section 168(k) is amended by striking paragraph (4).

(16) Section 168(k)(5) is amended by striking subparagraph (E).

(17) Section 168(m)(2)(B)(i) is amended by striking "(determined without regard to paragraph (4) thereof)".

(18) Section 168(m)(2) is amended by striking subparagraph (D).

(19) Section 173 is amended by striking subsection (b).

(20) Section 263(c) is amended by striking "section 59(e) or 291" and inserting "section 291".

(21) Section 263A(c) is amended by striking paragraph (6) and by redesignating paragraph (7) (as amended) as paragraph (6).

(22) Section 382(l) is amended by striking paragraph (7) and by redesignating paragraph (8) as paragraph (7).

(23) Section 443 is amended by striking subsection (d) and by redesignating subsection (e) as subsection (d).

(24) Section 616 is amended by striking subsection (e).

(25) Section 617 is amended by striking subsection (i).

(26) Section 641(c) is amended—

(A) in paragraph (2) by striking subparagraph (B) and by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively, and

(B) in paragraph (3), by striking "paragraph (2)(C)" and inserting "paragraph (2)(B)".

(27) Subsections (b) and (c) of section 666 are each amended by striking "(other than the tax imposed by section 55)".

(28) Section 848 is amended by striking subsection (i).

(29) Section 860E(a) is amended by striking paragraph (4).

(30) Section 871(b)(1) is amended by striking "or 55".

(31) Section 882(a)(1) is amended by striking "55,".

(32) Section 897(a) is amended to read as follows:

"(a) TREATMENT AS EFFECTIVELY CONNECTED WITH UNITED STATES TRADE OR BUSINESS.—For purposes of this title, gain or loss of a nonresident alien individual or a foreign corporation from the disposition of a United States real property interest shall be taken into account—

"(1) in the case of a nonresident alien individual, under section 871(b)(1), or

"(2) in the case of a foreign corporation, under section 882(a)(1),

as if the taxpayer were engaged in a trade or business within the United States during the taxable year and as if such gain or loss were effectively connected with such trade or business.".

(33) Section 904(k) is amended to read as follows:

"(k) CROSS REFERENCE.—For increase of limitation under subsection (a) for taxes paid with respect to amounts received which were included in the gross income of the taxpayer for a prior taxable year as a United States shareholder with respect to a controlled foreign corporation, see section 960(b).".

(34) Section 911(f) is amended to read as follows:

"(f) DETERMINATION OF TAX LIABILITY.—

"(1) IN GENERAL.—If, for any taxable year, any amount is excluded from gross income of a taxpayer under subsection (a), then, notwithstanding section 1, if such taxpayer has taxable income for such taxable year, the tax imposed by section 1 for such taxable year shall be equal to the excess (if any) of—

"(A) the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were increased by the amount excluded under subsection (a) for such taxable year, over

"(B) the tax which would be imposed by section 1 for such taxable year if the taxpayer's taxable income were equal to the amount excluded under subsection (a) for such taxable year.

For purposes of this paragraph, the amount excluded under subsection (a) shall be reduced by the aggregate amount of any deductions or exclusions disallowed under subsection (d)(6) with respect to such excluded amount.

"(2) TREATMENT OF CAPITAL GAIN EXCESS.—

"(A) IN GENERAL.—In applying section 1(h) for purposes of determining the tax under paragraph (1)(A) for any taxable year in which, without regard to this subsection, the taxpayer's net capital gain exceeds taxable income (hereafter in this subparagraph referred to as the capital gain excess)—

"(i) the taxpayer's net capital gain (determined without regard to section 1(h)(11)) shall be reduced (but not below zero) by such capital gain excess,

"(ii) the taxpayer's qualified dividend income shall be reduced by so much of such capital gain excess as exceeds the taxpayer's net capital gain (determined without regard to section 1(h)(11) and the reduction under clause (i)), and

"(iii) adjusted net capital gain, unrecaptured section 1250 gain, and 28-percent rate gain shall each be determined after increasing the amount described in section 1(h)(4)(B) by such capital gain excess.

"(B) DEFINITIONS.—Terms used in this paragraph which are also used in section 1(h) shall have the respective meanings given such terms by section 1(h).".

(35) Section 962(a)(1) is amended—

(A) by striking "sections 1 and 55" and inserting "section 1", and

(B) by striking "sections 11 and 55" and inserting "section 11".

(36) Section 1016(a) is amended by striking paragraph (20).

(37) Section 1202(a)(4) is amended by inserting “and” at the end of subparagraph (A), by striking “, and” and inserting a period at the end of subparagraph (B), and by striking subparagraph (C).

(38) Section 1374(b)(3)(B) is amended by striking the last sentence thereof.

(39) Section 1561(a) is amended—

(A) by inserting “and” at the end of paragraph (1), by striking “, and” at the end of paragraph (2) and inserting a period, and by striking paragraph (3), and

(B) by striking the last sentence.

(40) Section 6015(d)(2)(B) is amended by striking “or 55”.

(41) Section 6211(b)(4)(A) is amended by striking“, 168(k)(4)”.

(42) Section 6425(c)(1)(A) is amended to read as follows:

“(A) the tax imposed under section 11 or subchapter L of chapter 1, whichever is applicable, over”.

(43) Section 6654(d)(2) is amended—

(A) in clause (i) of subparagraph (B), by striking “, alternative minimum taxable income,”, and

(B) in clause (i) of subparagraph (C), by striking “, alternative minimum taxable income,”.

(44) Section 6655(e)(2)(B)(i) is amended by striking “The taxable income and alternative minimum taxable income shall” and inserting “Taxable income shall”.

(45) Section 6655(g)(1)(A) is amended by adding “plus” at the end of clause (i), by striking clause (ii), and by redesignating clause (iii) as clause (ii).

(46) Section 6662(e)(3)(C) is amended by striking “the regular tax (as defined in section 55(c))” and inserting “the regular tax liability (as defined in section 26(b))”.

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) PRIOR ELECTIONS WITH RESPECT TO CERTAIN TAX PREFERENCES.—So much of the amendment made by subsection (a) as relates to the repeal of section 59(e) of the Internal Revenue Code of 1986 shall apply to amounts paid or incurred after December 31, 2017.

(3) TREATMENT OF NET OPERATING LOSS CARRYBACKS.—For purposes of section 56(d) of the Internal Revenue Code of 1986 (as in effect before its repeal), the amount of any net operating loss which may be carried back from a taxable year beginning after December 31, 2017, to taxable years beginning before January 1, 2018, shall be determined without regard to any adjustments under section 56(d)(2)(A) of such Code (as so in effect).

TITLE III—BUSINESS TAX REFORM

Subtitle A—Tax Rates

SEC. 3001. REDUCTION IN CORPORATE TAX RATE.

(a) IN GENERAL.—Section 11(b) is amended to read as follows:

“(b) AMOUNT OF TAX.—

“(1) IN GENERAL.—Except as otherwise provided in this subsection, the amount of the tax imposed by subsection (a) shall be 20 percent of taxable income.

“(2) SPECIAL RULE FOR PERSONAL SERVICE CORPORATIONS.—

“(A) IN GENERAL.—In the case of a personal service corporation (as defined in section 448(d)(2)), the amount of the tax imposed by subsection (a) shall be 25 percent of taxable income.

“(B) REFERENCES TO CORPORATE RATE.—Any reference to the rate imposed under this section or to the highest rate in effect under this section (or any similar reference) shall be determined without regard to the rate imposed with respect to personal service corporations (as so defined).”.

(b) CONFORMING AMENDMENTS.—

(1)(A) Part I of subchapter P of chapter 1 is amended by striking section 1201 (and by striking the item relating to such section in the table of sections for such part).

(B) Section 12 is amended by striking paragraph (4).

(C) Section 527(b) is amended—

(i) by striking paragraph (2), and

(ii) by striking all that precedes "is hereby imposed" and inserting:

"(b) TAX IMPOSED.—A tax".

(D) Section 594(a) is amended by striking "taxes imposed by section 11 or 1201(a)" and inserting "tax imposed by section 11".

(E) Section 691(c)(4) is amended by striking "1201,".

(F) Section 801(a) is amended—

(i) by striking paragraph (2), and

(ii) by striking all that precedes "is hereby imposed" and inserting:

"(a) TAX IMPOSED.—A tax".

(G) Section 831(e) is amended by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(H) Sections 832(c)(5) and 834(b)(1)(D) are each amended by striking "sec. 1201 and following,".

(I) Section 852(b)(3)(A) is amended by striking "section 1201(a)" and inserting "section 11(b)(1)".

(J) Section 857(b)(3) is amended—

(i) by striking subparagraph (A) and redesignating subparagraphs (B) through (F) as subparagraphs (A) through (E), respectively,

(ii) in subparagraph (C), as so redesignated—

(I) by striking "subparagraph (A)(ii)" in clause (i) thereof and inserting "paragraph (1)",

(II) by striking "the tax imposed by subparagraph (A)(ii)" in clauses (ii) and (iv) thereof and inserting "the tax imposed by paragraph (1) on undistributed capital gain",

(iii) in subparagraph (E), as so redesignated, by striking "subparagraph (B) or (D)" and inserting "subparagraph (A) or (C)", and

(iv) by adding at the end the following new subparagraph:

"(F) UNDISTRIBUTED CAPITAL GAIN.—For purposes of this paragraph, the term 'undistributed capital gain' means the excess of the net capital gain over the deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only.".

(K) Section 882(a)(1) is amended by striking ", or 1201(a)".

(L) Section 1374(b) is amended by striking paragraph (4).

(M) Section 1381(b) is amended by striking "taxes imposed by section 11 or 1201" and inserting "tax imposed by section 11".

(N) Section 6655(g)(1)(A)(i) is amended by striking "or 1201(a),".

(O) Section 7518(g)(6)(A) is amended by striking "or 1201(a)".

(2) Section 1445(e)(1) is amended by striking "35 percent (or, to the extent provided in regulations, 20 percent)" and inserting "20 percent".

(3) Section 1445(e)(2) is amended by striking "35 percent" and inserting "20 percent".

(4) Section 1445(e)(6) is amended by striking "35 percent (or, to the extent provided in regulations, 20 percent)" and inserting "20 percent".

(5)(A) Part I of subchapter B of chapter 5 is amended by striking section 1551 (and by striking the item relating to such section in the table of sections for such part).

(B) Section 12 is amended by striking paragraph (6).

(C) Section 535(c)(5) is amended to read as follows:

"(5) CROSS REFERENCE.—For limitation on credit provided in paragraph (2) or (3) in the case of certain controlled corporations, see section 1561.".

(6)(A) Section 1561, as amended by the preceding provisions of this Act, is amended to read as follows:

"SEC. 1561. LIMITATION ON ACCUMULATED EARNINGS CREDIT IN THE CASE OF CERTAIN CONTROLLED CORPORATIONS.

"(a) IN GENERAL.—The component members of a controlled group of corporations on a December 31 shall, for their taxable years which include such December 31, be limited for purposes of this subtitle to one $250,000 ($150,000 if any component member is a corporation described in section 535(c)(2)(B)) amount for purposes of computing the accumulated earnings credit under section 535(c)(2) and (3). Such amount shall be divided equally among the component members of such group on such December 31 unless the Secretary prescribes regulations permitting an unequal allocation of such amount.

"(b) CERTAIN SHORT TAXABLE YEARS.—If a corporation has a short taxable year which does not include a December 31 and is a component member of a controlled group of corporations with respect to such taxable year, then for purposes of this subtitle, the amount to be used in computing the accumulated earnings credit under section 535(c)(2) and (3) of such corporation for such taxable year shall be the amount specified in subsection (a) with respect to such group, divided by the number of corporations which are component members of such group on the last day of such taxable year. For purposes of the preceding sentence, section 1563(b) shall be applied as if such last day were substituted for December 31.".

(B) The table of sections for part II of subchapter B of chapter 5 is amended by striking the item relating to section 1561 and inserting the following new item:

"Sec. 1561. Limitation on accumulated earnings credit in the case of certain controlled corporations.".

(7) Section 7518(g)(6)(A) is amended—

(A) by striking "With respect to the portion" and inserting "In the case of a taxpayer other than a corporation, with respect to the portion", and

(B) by striking "(34 percent in the case of a corporation)".

(c) REDUCTION IN DIVIDEND RECEIVED DEDUCTIONS TO REFLECT LOWER CORPORATE INCOME TAX RATES.—

(1) DIVIDENDS RECEIVED BY CORPORATIONS.—

(A) IN GENERAL.—Section 243(a)(1) is amended by striking "70 percent" and inserting "50 percent".

(B) DIVIDENDS FROM 20-PERCENT OWNED CORPORATIONS.—Section 243(c)(1) is amended—

(i) by striking "80 percent" and inserting "65 percent", and

(ii) by striking "70 percent" and inserting "50 percent".

(C) CONFORMING AMENDMENT.—The heading for section 243(c) is amended by striking "RETENTION OF 80-PERCENT DIVIDEND RECEIVED DEDUCTION" and inserting "INCREASED PERCENTAGE".

(2) DIVIDENDS RECEIVED FROM FSC.—Section 245(c)(1)(B) is amended—

(A) by striking "70 percent" and inserting "50 percent", and

(B) by striking "80 percent" and inserting "65 percent".

(3) LIMITATION ON AGGREGATE AMOUNT OF DEDUCTIONS.—Section 246(b)(3) is amended—

(A) by striking "80 percent" in subparagraph (A) and inserting "65 percent", and

(B) by striking "70 percent" in subparagraph (B) and inserting "50 percent".

(4) REDUCTION IN DEDUCTION WHERE PORTFOLIO STOCK IS DEBT-FINANCED.—Section 246A(a)(1) is amended—

(A) by striking "70 percent" and inserting "50 percent", and

(B) by striking "80 percent" and inserting "65 percent".

(5) INCOME FROM SOURCES WITHIN THE UNITED STATES.—Section 861(a)(2) is amended—

(A) by striking "100/70th" and inserting "100/50th" in subparagraph (B), and

(B) in the flush sentence at the end—

(i) by striking "100/80th" and inserting "100/65th", and

(ii) by striking "100/70th" and inserting "100/50th".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) CERTAIN CONFORMING AMENDMENTS.—The amendments made by paragraphs (2), (3), and (4) of subsection (b) shall apply to distributions after December 31, 2017.

(e) NORMALIZATION REQUIREMENTS.—

(1) IN GENERAL.—A normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Internal Revenue Code of 1986 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.

(2) ALTERNATIVE METHOD FOR CERTAIN TAXPAYERS.—If, as of the first day of the taxable year that includes the date of enactment of this Act—

(A) the taxpayer was required by a regulatory agency to compute depreciation for public utility property on the basis of an average life or composite rate method, and

(B) the taxpayer's books and underlying records did not contain the vintage account data necessary to apply the average rate assumption method,

the taxpayer will be treated as using a normalization method of accounting if, with respect to such jurisdiction, the taxpayer uses the alternative method for public utility property that is subject to the regulatory authority of that jurisdiction.

(3) DEFINITIONS.—For purposes of this subsection—

(A) EXCESS TAX RESERVE.—The term "excess tax reserve" means the excess of—

(i) the reserve for deferred taxes (as described in section 168(i)(9)(A)(ii) of the Internal Revenue Code of 1986 as in effect on the day before the date of the enactment of this Act), over

(ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods.

(B) AVERAGE RATE ASSUMPTION METHOD.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, if timing differences for the property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying—

(i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by

(ii) the amount of the timing differences which reverse during such period.

(C) ALTERNATIVE METHOD.—The "alternative method" is the method in which the taxpayer—

(i) computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and

(ii) reduces the excess tax reserve ratably over the remaining regulatory life of the property.

(4) TAX INCREASED FOR NORMALIZATION VIOLATION.—If, for any taxable year ending after the date of the enactment of this Act, the taxpayer does not use a normalization method of accounting, the taxpayer's tax for the taxable year shall be increased by the amount by which it reduces its excess tax reserve more rapidly than permitted under a normalization method of accounting.

Subtitle B—Cost Recovery

SEC. 3101. INCREASED EXPENSING.

(a) 100 PERCENT EXPENSING.—Section 168(k)(1)(A) is amended by striking "50 percent" and inserting "100 percent".

(b) EXTENSION THROUGH JANUARY 1, 2023.—Section 168(k)(2) is amended—

(1) in subparagraph (A)(iii), by striking "January 1, 2020" and inserting "January 1, 2023",

(2) in subparagraph (B)(i)(II), by striking "January 1, 2021" and inserting "January 1, 2024",

(3) in subparagraph (B)(i)(III), by striking "January 1, 2020" and inserting "January 1, 2023",

(4) in subparagraph (B)(ii), by striking "January 1, 2020" in each place it appears and inserting "January 1, 2023", and

(5) in subparagraph (E)(i), by striking "January 1, 2020" and replacing it with "January 1, 2023".

(c) APPLICATION TO USED PROPERTY.—

(1) IN GENERAL.—Section 168(k)(2)(A)(ii) is amended to read as follows:

"(ii) the original use of which begins with the taxpayer or the acquisition of which by the taxpayer meets the requirements of clause (ii) of subparagraph (E), and".

(2) ACQUISITION REQUIREMENTS.—Section 168(k)(2)(E)(ii) is amended to read as follows:

"(ii) ACQUISITION REQUIREMENTS.—An acquisition of property meets the requirements of this clause if—

"(I) such property was not used by the taxpayer at any time prior to such acquisition, and

"(II) the acquisition of such property meets the requirements of paragraphs (2)(A), (2)(B), (2)(C), and (3) of section 179(d).",

(3) ANTI-ABUSE RULES.—Section 168(k)(2)(E) is further amended by amending clause (iii)(I) to read as follows:

"(I) property is used by a lessor of such property and such use is the lessor's first use of such property,".

(d) EXCEPTION FOR CERTAIN TRADES AND BUSINESSES NOT SUBJECT TO LIMITATION ON INTEREST EXPENSE.—Section 168(k)(2), as amended by section 2001, is amended by inserting after subparagraph (F) the following new subparagraph:

"(G) EXCEPTION FOR PROPERTY OF CERTAIN BUSINESSES NOT SUBJECT TO LIMITATION ON INTEREST EXPENSE.—The term 'qualified property' shall not include any property used in—

"(i) a trade or business described in subparagraph (B) or (C) of section 163(j)(7), or

"(ii) a trade or business that has had floor plan financing indebtedness (as defined in paragraph (9) of section 163(j)), if the floor plan financing interest related to such indebtedness was taken into account under paragraph (1)(C) of such section.".

(e) COORDINATION WITH SECTION 280F.—Section 168(k)(2)(F) is amended—

(1) by striking "$8,000" in clauses (i) and (iii) and inserting "$16,000", and

(2) in clause (iii)—

(A) by striking "placed in service by the taxpayer after December 31, 2017" and inserting "acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017", and

(B) by redesignating subclauses (I) and (II) as subclauses (II) and (III) respectively, and inserting before clause (II), as so redesignated, the following new subclause:

"(I) in the case of a passenger automobile placed in service before January 1, 2018, '$8,000',".

(f) CONFORMING AMENDMENTS.—

(1) Section 168(k)(2)(B)(i)(III), as amended, is amended by inserting "binding" before "contract".

(2) Section 168(k)(5) is amended by—

(A) by striking "January 1, 2020" in subparagraph (A) and inserting "January 1, 2023",

(B) by striking "50 percent" in subparagraph (A)(i) and inserting "100 percent", and

(C) by striking subparagraph (F).

(3) Section 168(k)(6) is amended to read as follows:

"(6) PHASE DOWN.—In the case of qualified property acquired by the taxpayer before September 28, 2017, and placed in service by the taxpayer after September 27, 2017, paragraph (1)(A) shall be applied by substituting for '100 percent'—

"(A) '50 percent' in the case of—

"(i) property placed in service before January 1, 2018, and

"(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2018,

"(B) '40 percent' in the case of—

"(i) property placed in service in 2018 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

"(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2019, and

"(C) '30 percent' in the case of—

"(i) property placed in service in 2019 (other than property described in subparagraph (B) or (C) of paragraph (2)), and

"(ii) property described in subparagraph (B) or (C) of paragraph (2) which is placed in service in 2020.".

(4) The heading of section 168(k) is amended by striking "SPECIAL ALLOWANCE FOR CERTAIN PROPERTY ACQUIRED AFTER DECEMBER 31, 2007, AND BEFORE JANUARY 1, 2020" and inserting "FULL EXPENSING OF CERTAIN PROPERTY".

(5) Section 460(c)(6)(B)(ii) is amended by striking "January 1, 2020 (January 1, 2021 in the case of property described in section 168(k)(2)(B))" and inserting "January 1, 2023 (January 1, 2024 in the case of property described in section 168(k)(2)(B))".

(g) EFFECTIVE DATE.—

(1) IN GENERAL.—Except at provided by paragraph (2), the amendments made by this section shall apply to property which—

(A) is acquired after September 27, 2017, and

(B) is placed in service after such date.

For purposes of the preceding sentence, property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition.

(2) SPECIFIED PLANTS.—The amendments made by subsection (f)(2) shall apply to specified plants planted or grafted after September 27, 2017.

(3) TRANSITION RULE.—In the case of any taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect (at such time and in such form and manner as the Secretary of the Treasury, or his designee, may provide) to apply section 168 of the Internal Revenue Code of 1986 without regard to the amendments made by this section.

(4) LIMITATION ON NET OPERATING LOSS CARRYBACKS ATTRIBUTABLE TO FULL EXPENSING.—In the case of any taxable year which includes any portion of the period beginning on September 28, 2017, and ending on December 31, 2017, the amount of any net operating loss for such taxable year which may be treated as a net operating loss carryback (including any such carryback attributable to any specified liability loss under section 172(b)(1)(C), any corporate equity reduction interest loss under section 172(b)(1)(D), any eligible loss under section 172(b)(1)(E), and any farming loss under section 172(b)(1)(F)) shall be determined without regard to the amendments made by this section. For purposes of this paragraph, terms which are used in section 172 of the Internal Revenue Code of 1986 (determined without regard to the amendments made by section 3302) shall have the same meaning as when used in such section.

Subtitle C—Small Business Reforms

SEC. 3201. EXPANSION OF SECTION 179 EXPENSING.

(a) INCREASED DOLLAR LIMITATIONS.—

(1) IN GENERAL.—Section 179(b) is amended—

(A) by inserting "($5,000,000, in the case of taxable years beginning before January 1, 2023)" after "$500,000" in paragraph (1), and

(B) by inserting "($20,000,000, in the case of taxable years beginning before January 1, 2023)" after "$2,000,000" in paragraph (2).

(2) INFLATION ADJUSTMENT.—Section 179(b)(6) is amended to read as follows:

"(6) INFLATION ADJUSTMENT.—

"(A) IN GENERAL.—In the case of a taxable year beginning after 2015 (2018 in the case of the $5,000,000 and $20,000,000 amounts in subsection (b)), each dollar amount in subsection (b) shall be increased by an amount equal to such dollar amount multiplied by—

"(i) in the case of the $500,000 and $2,000,000 amounts in subsection (b), the cost-of-living adjustment determined under section 1(c)(2) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2014' for 'calendar year 2016' in subparagraph (A)(ii) thereof, and

"(ii) in the case of the $5,000,000 and $20,000,000 amounts in subsection (b), the cost-of-living adjustment determined under section 1(c)(2) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2017' for 'calendar year 2016' in subparagraph (A)(ii) thereof.

"(B) ROUNDING.—The amount of any increase under subparagraph (A) shall be rounded to the nearest multiple of $10,000 ($100,000 in the case of the $5,000,000 and $20,000,000 amounts in subsection (b)).".

(b) APPLICATION TO QUALIFIED ENERGY EFFICIENT HEATING AND AIR-CONDITIONING PROPERTY.—

(1) IN GENERAL.—Section 179(f)(2) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by adding at the end the following new subparagraph:

"(D) qualified energy efficient heating and air-conditioning property.".

(2) QUALIFIED ENERGY EFFICIENT HEATING AND AIR-CONDITIONING PROPERTY.—Section 179(f) is amended by adding at the end the following new paragraph:

"(3) QUALIFIED ENERGY EFFICIENT HEATING AND AIR-CONDITIONING PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified energy efficient heating and air-conditioning property' means any section 1250 property—

"(i) with respect to which depreciation (or amortization in lieu of depreciation) is allowable,

"(ii) which is installed as part of a building's heating, cooling, ventilation, or hot water system, and

"(iii) which is within the scope of Standard 90.1–2007 or any successor standard.

"(B) STANDARD 90.1–2007.—The term 'Standard 90.1–2007' means Standard 90.1–2007 of the American Society of Heating, Refrigerating and Air-

Conditioning Engineers and the Illuminating Engineering Society of North America (as in effect on the day before the date of the adoption of Standard 90.1–2010 of such Societies).".

(c) EFFECTIVE DATE.—

(1) INCREASED DOLLAR LIMITATIONS.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 2017.

(2) APPLICATION TO QUALIFIED ENERGY EFFICIENT HEATING AND AIR-CONDITIONING PROPERTY.—The amendments made by subsection (b) shall apply to property acquired and placed in service after November 2, 2017. For purposes of the preceding sentence, property shall not be treated as acquired after the date on which a written binding contract is entered into for such acquisition.

SEC. 3202. SMALL BUSINESS ACCOUNTING METHOD REFORM AND SIMPLIFICATION.

(a) MODIFICATION OF LIMITATION ON CASH METHOD OF ACCOUNTING.—

(1) INCREASED LIMITATION.—So much of section 448(c) as precedes paragraph (2) is amended to read as follows:

"(c) GROSS RECEIPTS TEST.—For purposes of this section—

"(1) IN GENERAL.—A corporation or partnership meets the gross receipts test of this subsection for any taxable year if the average annual gross receipts of such entity for the 3-taxable-year period ending with the taxable year which precedes such taxable year does not exceed $25,000,000.".

(2) APPLICATION OF EXCEPTION ON ANNUAL BASIS.—Section 448(b)(3) is amended to read as follows:

"(3) ENTITIES WHICH MEET GROSS RECEIPTS TEST.—Paragraphs (1) and (2) of subsection (a) shall not apply to any corporation or partnership for any taxable year if such entity (or any predecessor) meets the gross receipts test of subsection (c) for such taxable year.".

(3) INFLATION ADJUSTMENT.—Section 448(c) is amended by adding at the end the following new paragraph:

"(4) ADJUSTMENT FOR INFLATION.—In the case of any taxable year beginning after December 31, 2018, the dollar amount in paragraph (1) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(c)(2) for the calendar year in which the taxable year begins, by substituting 'calendar year 2017' for 'calendar year 2016' in subparagraph (A)(ii) thereof.

If any amount as increased under the preceding sentence is not a multiple of $1,000,000, such amount shall be rounded to the nearest multiple of $1,000,000.".

(4) COORDINATION WITH SECTION 481.—Section 448(d)(7) is amended to read as follows:

"(7) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this section shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.".

(5) APPLICATION OF EXCEPTION TO CORPORATIONS ENGAGED IN FARMING.—

(A) IN GENERAL.—Section 447(c) is amended—

(i) by inserting "for any taxable year" after "not being a corporation" in the matter preceding paragraph (1), and

(ii) by amending paragraph (2) to read as follows:

"(2) a corporation which meets the gross receipts test of section 448(c) for such taxable year.".

(B) COORDINATION WITH SECTION 481.—Section 447(f) is amended to read as follows:

"(f) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this section shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.".

(C) CONFORMING AMENDMENTS.—Section 447 is amended—

(i) by striking subsections (d), (e), (h), and (i), and

(ii) by redesignating subsections (f) and (g) (as amended by subparagraph (B)) as subsections (d) and (e), respectively.

(b) EXEMPTION FROM UNICAP REQUIREMENTS.—

(1) IN GENERAL.—Section 263A is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—

"(1) IN GENERAL.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, this section shall not apply with respect to such taxpayer for such taxable year.

"(2) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC.— In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

"(3) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.".

(2) CONFORMING AMENDMENT.—Section 263A(b)(2) is amended to read as follows:

"(2) PROPERTY ACQUIRED FOR RESALE.—Real or personal property described in section 1221(a)(1) which is acquired by the taxpayer for resale.".

(c) EXEMPTION FROM INVENTORIES.—Section 471 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—

"(1) IN GENERAL.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year—

"(A) subsection (a) shall not apply with respect to such taxpayer for such taxable year, and

"(B) the taxpayer's method of accounting for inventory for such taxable year shall not be treated as failing to clearly reflect income if such method either—

"(i) treats inventory as non-incidental materials and supplies, or

"(ii) conforms to such taxpayer's method of accounting reflected in an applicable financial statement of the taxpayer with respect to such taxable year or, if the taxpayer does not have any applicable financial statement with respect to such taxable year, the books and records of the taxpayer prepared in accordance with the taxpayer's accounting procedures.

"(2) APPLICABLE FINANCIAL STATEMENT.—For purposes of this subsection, the term 'applicable financial statement' means—

"(A) a financial statement which is certified as being prepared in accordance with generally accepted accounting principles and which is—

"(i) a 10-K (or successor form), or annual statement to shareholders, required to be filed by the taxpayer with the United States Securities and Exchange Commission,

"(ii) an audited financial statement of the taxpayer which is used for—

"(I) credit purposes,

"(II) reporting to shareholders, partners, or other proprietors, or to beneficiaries, or

"(III) any other substantial nontax purpose,

but only if there is no statement of the taxpayer described in clause (i), or

"(iii) filed by the taxpayer with any other Federal or State agency for nontax purposes, but only if there is no statement of the taxpayer described in clause (i) or (ii), or

"(B) a financial statement of the taxpayer which—

"(i) is used for a purpose described in subclause (I), (II), or (III) of subparagraph (A)(ii), or

"(ii) filed by the taxpayer with any regulatory or governmental body (whether domestic or foreign) specified by the Secretary,

but only if there is no statement of the taxpayer described in subparagraph (A).

"(3) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC.—In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

"(4) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the taxpayer and made with the consent of the Secretary.".

(d) EXEMPTION FROM PERCENTAGE COMPLETION FOR LONG-TERM CONTRACTS.—

(1) IN GENERAL.—Section 460(e)(1)(B) is amended—

(A) by inserting "(other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3))" after "taxpayer" in the matter preceding clause (i), and

(B) by amending clause (ii) to read as follows:

"(ii) who meets the gross receipts test of section 448(c) for the taxable year in which such contract is entered into.".

(2) CONFORMING AMENDMENTS.—Section 460(e) is amended by striking paragraphs (2) and (3), by redesignating paragraphs (4), (5), and (6) as paragraphs (3), (4), and (5), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) RULES RELATED TO GROSS RECEIPTS TEST.—

"(A) APPLICATION OF GROSS RECEIPTS TEST TO INDIVIDUALS, ETC.— For purposes of paragraph (1)(B)(ii), in the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

"(B) COORDINATION WITH SECTION 481.—Any change in method of accounting made pursuant to paragraph (1)(B)(ii) shall be treated as initiated by the taxpayer and made with the consent of the Secretary. Such change shall be effected on a cut-off basis for all similarly classified contracts entered into on or after the year of change.".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) PRESERVATION OF SUSPENSE ACCOUNT RULES WITH RESPECT TO ANY EXISTING SUSPENSE ACCOUNTS.—So much of the amendments made by subsection (a)(5)(C) as relate to section 447(i) of the Internal Revenue Code of 1986 shall not apply with respect to any suspense account established under such section before the date of the enactment of this Act.

(3) EXEMPTION FROM PERCENTAGE COMPLETION FOR LONG-TERM CONTRACTS.— The amendments made by subsection (d) shall apply to contracts entered into after December 31, 2017, in taxable years ending after such date.

SEC. 3203. SMALL BUSINESS EXCEPTION FROM LIMITATION ON DEDUCTION OF BUSINESS INTEREST.

(a) IN GENERAL.—Section 163(j)(2), as amended by section 3301, is amended to read as follows:

"(2) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year, paragraph (1) shall not apply to such taxpayer for such taxable year. In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if such taxpayer were a corporation or partnership.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3204. MODIFICATION OF TREATMENT OF S CORPORATION CONVERSIONS TO C CORPORATIONS.

(a) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.—Section 481 is amended by adding at the end the following new subsection:

"(d) ADJUSTMENTS ATTRIBUTABLE TO CONVERSION FROM S CORPORATION TO C CORPORATION.—

"(1) IN GENERAL.—In the case of an eligible terminated S corporation, any adjustment required by subsection (a)(2) which is attributable to such corporation's revocation described in paragraph (2)(A)(ii) shall be taken into account ratably during the 6-taxable year period beginning with the year of change.

"(2) ELIGIBLE TERMINATED S CORPORATION.—For purposes of this subsection, the term 'eligible terminated S corporation' means any C corporation—

"(A) which—

"(i) was an S corporation on the day before the date of the enactment of the Tax Cuts and Jobs Act, and

"(ii) during the 2-year period beginning on the date of such enactment makes a revocation of its election under section 1362(a), and

"(B) the owners of the stock of which, determined on the date such revocation is made, are the same owners (and in identical proportions) as on the date of such enactment.".

(b) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD FROM S CORPORATION STATUS.—Section 1371 is amended by adding at the end the following new subsection:

"(f) CASH DISTRIBUTIONS FOLLOWING POST-TERMINATION TRANSITION PERIOD.—In the case of a distribution of money by an eligible terminated S corporation (as defined in section 481(d)) after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.".

Subtitle D—Reform of Business-related Exclusions, Deductions, etc.

SEC. 3301. INTEREST.

(a) IN GENERAL.—Section 163(j) is amended to read as follows:

"(j) LIMITATION ON BUSINESS INTEREST.—

"(1) IN GENERAL.—In the case of any taxpayer for any taxable year, the amount allowed as a deduction under this chapter for business interest shall not exceed the sum of—

"(A) the business interest income of such taxpayer for such taxable year,

"(B) 30 percent of the adjusted taxable income of such taxpayer for such taxable year, plus

"(C) the floor plan financing interest of such taxpayer for such taxable year.

The amount determined under subparagraph (B) (after any increases in such amount under paragraph (3)(A)(iii)) shall not be less than zero.

"(2) EXEMPTION FOR CERTAIN SMALL BUSINESSES.—For exemption for certain small businesses, see the amendment made by section 3203 of the Tax Cuts and Jobs Act.

"(3) APPLICATION TO PARTNERSHIPS, ETC.—

"(A) IN GENERAL.—In the case of any partnership—

"(i) this subsection shall be applied at the partnership level and any deduction for business interest shall be taken into account in determining the non-separately stated taxable income or loss of the partnership,

"(ii) the adjusted taxable income of each partner of such partnership shall be determined without regard to such partner's distributive share of the non-separately stated taxable income or loss of such partnership, and

"(iii) the amount determined under paragraph (1)(B) with respect to each partner of such partnership shall be increased by such partner's distributive share of such partnership's excess amount.

"(B) EXCESS AMOUNT.—The term 'excess amount' means, with respect to any partnership, the excess (if any) of—

"(i) 30 percent of the adjusted taxable income of the partnership, over

"(ii) the amount (if any) by which the business interest of the partnership, reduced by floor plan financing interest, exceeds the business interest income of the partnership.

"(C) APPLICATION TO S CORPORATIONS.—Rules similar to the rules of subparagraphs (A) and (B) shall apply with respect to any S corporation and its shareholders.

"(4) BUSINESS INTEREST.—For purposes of this subsection, the term 'business interest' means any interest paid or accrued on indebtedness properly allocable to a trade or business. Such term shall not include investment interest (within the meaning of subsection (d)).

"(5) BUSINESS INTEREST INCOME.—For purposes of this subsection, the term 'business interest income' means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Such term shall not include investment income (within the meaning of subsection (d)).

"(6) ADJUSTED TAXABLE INCOME.—For purposes of this subsection, the term 'adjusted taxable income' means the taxable income of the taxpayer—

"(A) computed without regard to—

"(i) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business,

"(ii) any business interest or business interest income,

"(iii) the amount of any net operating loss deduction under section 172, and "(iv) any deduction allowable for depreciation, amortization, or depletion, and

"(B) computed with such other adjustments as the Secretary may provide.

"(7) TRADE OR BUSINESS.—For purposes of this subsection, the term 'trade or business' shall not include—

"(A) the trade or business of performing services as an employee,

"(B) a real property trade or business (as such term is defined in section 469(c)(7)(C)), or

"(C) the trade or business of the furnishing or sale of—

"(i) electrical energy, water, or sewage disposal services,

"(ii) gas or steam through a local distribution system, or

"(iii) transportation of gas or steam by pipeline,

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

"(8) CARRYFORWARD OF DISALLOWED INTEREST.—For carryforward of interest disallowed under paragraph (1), see subsection (o).

"(9) FLOOR PLAN FINANCING INTEREST DEFINED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'floor plan financing interest' means interest paid or accrued on floor plan financing indebtedness.

"(B) FLOOR PLAN FINANCING INDEBTEDNESS.—The term 'floor plan financing indebtedness' means indebtedness—

"(i) used to finance the acquisition of motor vehicles held for sale to retail customers, and

"(ii) secured by the inventory so acquired.

"(C) MOTOR VEHICLE.—The term 'motor vehicle' means a motor vehicle that is any of the following:

"(i) An automobile.

"(ii) A truck.

"(iii) A recreational vehicle.

"(iv) A motorcycle.

"(v) A boat.

"(vi) Farm machinery or equipment.

"(vii) Construction machinery or equipment.".

(b) CARRYFORWARD OF DISALLOWED BUSINESS INTEREST.—Section 163, after amendment by section 4302(a) and before amendment by section 4302(b), is amended by inserting after subsection (n) the following new subsection:

"(o) CARRYFORWARD OF DISALLOWED BUSINESS INTEREST.—The amount of any business interest not allowed as a deduction for any taxable year by reason of subsection (j) shall be treated as business interest paid or accrued in the succeeding taxable year. Business interest paid or accrued in any taxable year (determined without regard to the preceding sentence) shall not be carried past the 5th taxable year following such taxable year, determined by treating business interest as allowed as a deduction on a first-in, first-out basis.".

(c) TREATMENT OF CARRYFORWARD OF DISALLOWED BUSINESS INTEREST IN CERTAIN CORPORATE ACQUISITIONS.—

(1) IN GENERAL.—Section 381(c) is amended by inserting after paragraph (19) the following new paragraph:

"(20) CARRYFORWARD OF DISALLOWED INTEREST.—The carryover of disallowed interest described in section 163(o) to taxable years ending after the date of distribution or transfer.".

(2) APPLICATION OF LIMITATION.—Section 382(d) is amended by adding at the end the following new paragraph:

"(3) APPLICATION TO CARRYFORWARD OF DISALLOWED INTEREST.—The term 'pre-change loss' shall include any carryover of disallowed interest described in section 163(o) under rules similar to the rules of paragraph (1).".

(3) CONFORMING AMENDMENT.—Section 382(k)(1) is amended by inserting after the first sentence the following: "Such term shall include any corporation entitled to use a carryforward of disallowed interest described in section 381(c)(20)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3302. MODIFICATION OF NET OPERATING LOSS DEDUCTION.

(a) INDEFINITE CARRYFORWARD OF NET OPERATING LOSSES.—Section 172(b)(1)(A)(ii) is amended by striking "to each of the 20 taxable years" and inserting "to each taxable year".

(b) REPEAL OF NET OPERATING LOSS CARRYBACKS OTHER THAN 1-YEAR CARRYBACK OF ELIGIBLE DISASTER LOSSES.—

(1) IN GENERAL.—Section 172(b)(1)(A)(i) is amended to read as follows:

"(i) in the case of any portion of a net operating loss for the taxable year which is an eligible disaster loss with respect to the taxpayer, shall be a net operating loss carryback to the taxable year preceding the taxable year of such loss, and".

(2) CONFORMING AMENDMENTS.—

(A) Section 172(b)(1) is amended by striking subparagraphs (B) through (F) and inserting the following:

"(B) ELIGIBLE DISASTER LOSS.—

"(i) IN GENERAL.—For purposes of subparagraph (A)(i), the term 'eligible disaster loss' means—

"(I) in the case of a taxpayer which is a small business, net operating losses attributable to federally declared disasters (as defined by section 165(i)(5)), and

"(II) in the case of a taxpayer engaged in the trade or business of farming, net operating losses attributable to such federally declared disasters.

"(ii) SMALL BUSINESS.—For purposes of this subparagraph, the term 'small business' means a corporation or partnership which meets the gross receipts test of section 448(c) (determined by substituting '$5,000,000' for '$25,000,000' each place it appears therein) for the taxable year in which the loss arose (or, in the case of a sole proprietorship, which would meet such test if such proprietorship were a corporation).

"(iii) TRADE OR BUSINESS OF FARMING.—For purposes of this subparagraph, the trade or business of farming shall include the trade or business of—

"(I) operating a nursery or sod farm, or

"(II) the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.

For purposes of subclause (II), an evergreen tree which is more than 6 years old at the time severed from the roots shall not be treated as an ornamental tree.".

(B) Section 172 is amended by striking subsections (f), (g), and (h).

(c) LIMITATION OF NET OPERATING LOSS TO 90 PERCENT OF TAXABLE INCOME.—

(1) IN GENERAL.—Section 172(a) is amended to read as follows:

"(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction for the taxable year an amount equal to the lesser of—

"(1) the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, or

"(2) 90 percent of taxable income computed without regard to the deduction allowable under this section.

For purposes of this subtitle, the term 'net operating loss deduction' means the deduction allowed by this subsection.".

(2) COORDINATION OF LIMITATION WITH CARRYBACKS AND CARRYOVERS.—Section 172(b)(2) is amended by striking "shall be computed—" and all that follows and inserting "shall—

"(A) be computed with the modifications specified in subsection (d) other than paragraphs (1), (4), and (5) thereof, and by determining the amount of the net operating loss deduction without regard to the net operating loss for the loss year or for any taxable year thereafter,

"(B) not be considered to be less than zero, and

"(C) not exceed the amount determined under subsection (a)(2) for such prior taxable year.".

(3) CONFORMING AMENDMENT.—Section 172(d)(6) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting "; and", and by adding at the end the following new subparagraph:

"(C) subsection (a)(2) shall be applied by substituting 'real estate investment trust taxable income (as defined in section 857(b)(2) but without regard to the deduction for dividends paid (as defined in section 561))' for 'taxable income'.".

(d) ANNUAL INCREASE OF INDEFINITE CARRYOVER AMOUNTS.—Section 172(b) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) ANNUAL INCREASE OF INDEFINITE CARRYOVER AMOUNTS.—For purposes of paragraph (2)—

"(A) the amount of any indefinite net operating loss which is carried to the next succeeding taxable year after the loss year (within the meaning of paragraph (2)) shall be increased by an amount equal to—

"(i) the amount of the loss which may be so carried over to such succeeding taxable year (determined without regard to this paragraph), multiplied by

"(ii) the sum of—

"(I) the annual Federal short-term rate (determined under section 1274(d)) for the last month ending before the beginning of such taxable year, plus

"(II) 4 percentage points, and

"(B) the amount of any indefinite net operating loss which is carried to any succeeding taxable year (after such next succeeding taxable year) shall be an amount equal to—

"(i) the excess of—

"(I) the amount of the loss carried to the prior taxable year (after any increase under this paragraph with respect to such amount), over

"(II) the amount by which such loss was reduced under paragraph (2) by reason of the taxable income for such prior taxable year, multiplied by

"(ii) a percentage equal to 100 percent plus the percentage determined under subparagraph (A)(ii) with respect to such succeeding taxable year.

For purposes of the preceding sentence, the term 'indefinite net operating loss' means any net operating loss arising in a taxable year beginning after December 31, 2017.".

(e) EFFECTIVE DATE.—

(1) CARRYFORWARDS AND CARRYBACKS.—The amendments made by subsections (a) and (b) shall apply to net operating losses arising in taxable years beginning after December 31, 2017.

(2) NET OPERATING LOSS LIMITED TO 90 PERCENT OF TAXABLE INCOME.—The amendments made by subsection (c) shall apply to taxable years beginning after December 31, 2017.

(3) ANNUAL INCREASE IN CARRYOVER AMOUNTS.—The amendments made by subsection (d) shall apply to amounts carried to taxable years beginning after December 31, 2017.

(4) SPECIAL RULE FOR NET DISASTER LOSSES.—Notwithstanding paragraph (1), the amendments made by subsection (b) shall not apply to the portion of the net operating loss for any taxable year which is a net disaster loss to which section 504(b) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017 applies.

SEC. 3303. LIKE-KIND EXCHANGES OF REAL PROPERTY.

(a) IN GENERAL.—Section 1031(a)(1) is amended by striking "property" each place it appears and inserting "real property".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 1031(a) is amended to read as follows:

"(2) EXCEPTION FOR REAL PROPERTY HELD FOR SALE.—This subsection shall not apply to any exchange of real property held primarily for sale.".

(2) Section 1031 is amended by striking subsections (e) and (i).

(3) Section 1031, as amended by paragraph (2), is amended by inserting after subsection (d) the following new subsection:

"(e) APPLICATION TO CERTAIN PARTNERSHIPS.—For purposes of this section, an interest in a partnership which has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.".

(4) Section 1031(h) is amended to read as follows:

"(h) SPECIAL RULES FOR FOREIGN REAL PROPERTY.—Real property located in the United States and real property located outside the United States are not property of a like kind.".

(5) The heading of section 1031 is amended by striking "**PROPERTY**" and inserting "**REAL PROPERTY**".

(6) The table of sections for part III of subchapter O of chapter 1 is amended by striking the item relating to section 1031 and inserting the following new item:

"Sec. 1031. Exchange of real property held for productive use or investment.".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to exchanges completed after December 31, 2017.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any exchange if—

(A) the property disposed of by the taxpayer in the exchange is disposed of on or before December 31 2017, or

(B) the property received by the taxpayer in the exchange is received on or before December 31, 2017.

SEC. 3304. REVISION OF TREATMENT OF CONTRIBUTIONS TO CAPITAL.

(a) INCLUSION OF CONTRIBUTIONS TO CAPITAL.—Part II of subchapter B of chapter 1 is amended by inserting after section 75 the following new section:

"SEC. 76. CONTRIBUTIONS TO CAPITAL.

"(a) IN GENERAL.—Gross income includes any contribution to the capital of any entity.

"(b) TREATMENT OF CONTRIBUTIONS IN EXCHANGE FOR STOCK, ETC.—

"(1) IN GENERAL.—In the case of any contribution of money or other property to a corporation in exchange for stock of such corporation—

"(A) such contribution shall not be treated for purposes of subsection (a) as a contribution to the capital of such corporation (and shall not be includible in the gross income of such corporation), and

"(B) no gain or loss shall be recognized to such corporation upon the issuance of such stock.

"(2) TREATMENT LIMITED TO VALUE OF STOCK.—For purposes of this subsection, a contribution of money or other property to a corporation shall be treated as being in exchange for stock of such corporation only to the extent that the fair market value of such money and other property does not exceed the fair market value of such stock.

"(3) APPLICATION TO ENTITIES OTHER THAN CORPORATIONS.—In the case of any entity other than a corporation, rules similar to the rules of paragraphs (1) and (2) shall apply in the case of any contribution of money or other property to such entity in exchange for any interest in such entity.

"(c) TREASURY STOCK TREATED AS STOCK.—Any reference in this section to stock shall be treated as including a reference to treasury stock.".

(b) BASIS OF CORPORATION IN CONTRIBUTED PROPERTY.—

(1) CONTRIBUTIONS TO CAPITAL.—Subsection (c) of section 362 is amended to read as follows:

"(c) CONTRIBUTIONS TO CAPITAL.—If property other than money is transferred to a corporation as a contribution to the capital of such corporation (within the meaning of section 76) then the basis of such property shall be the greater of—

"(1) the basis determined in the hands of the transferor, increased by the amount of gain recognized to the transferor on such transfer, or

"(2) the amount included in gross income by such corporation under section 76 with respect to such contribution.".

(2) CONTRIBUTIONS IN EXCHANGE FOR STOCK.—Paragraph (2) of section 362(a) is amended by striking "contribution to capital" and inserting "contribution in exchange for stock of such corporation (determined under rules similar to the rules of paragraphs (2) and (3) of section 76(b))".

(c) CONFORMING AMENDMENTS.—

(1) Section 108(e) is amended by striking paragraph (6).

(2) Part III of subchapter B of chapter 1 is amended by striking section 118 (and by striking the item relating to such section in the table of sections for such part).

(3) The table of sections for part II of subchapter B of chapter 1 is amended by inserting after the item relating to section 75 the following new item:

"Sec. 76. Contributions to capital.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made, and transactions entered into, after the date of the enactment of this Act.

SEC. 3305. REPEAL OF DEDUCTION FOR LOCAL LOBBYING EXPENSES.

(a) IN GENERAL.—Section 162(e) is amended by striking paragraphs (2) and (7) and by redesignating paragraphs (3), (4), (5), (6), and (8) as paragraphs (2), (3), (4), (5), and (6), respectively.

(b) CONFORMING AMENDMENT.—Section 6033(e)(1)(B)(ii) is amended by striking "section 162(e)(5)(B)(ii)" and inserting "section 162(e)(4)(B)(ii)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 2017.

SEC. 3306. REPEAL OF DEDUCTION FOR INCOME ATTRIBUTABLE TO DOMESTIC PRODUCTION ACTIVITIES.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 is amended by striking section 199 (and by striking the item relating to such section in the table of sections for such part).

(b) CONFORMING AMENDMENTS.—

(1) Sections 74(d)(2)(B), 86(b)(2)(A), 137(b)(3)(A), 219(g)(3)(A)(ii), and 246(b)(1) are each amended by striking "199,".

(2) Section 170(b)(2)(D), as amended by the preceding provisions of this Act, is amended by striking clause (iv), by redesignating clause (v) as clause (iv), and by inserting "and" at the end of clause (iii).

(3) Section 172(d) is amended by striking paragraph (7).

(4) Section 613(a) is amended by striking "and without the deduction under section 199".

(5) Section 613A(d)(1) is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively.

(6) Section 1402(a) is amended by adding "and" at the end of paragraph (15) and by striking paragraph (16).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3307. ENTERTAINMENT, ETC. EXPENSES.

(a) DENIAL OF DEDUCTION.—Subsection (a) of section 274 is amended to read as follows:

"(a) ENTERTAINMENT, AMUSEMENT, RECREATION, AND OTHER FRINGE BENEFITS .—

"(1) IN GENERAL.—No deduction otherwise allowable under this chapter shall be allowed for amounts paid or incurred for any of the following items:

"(A) ACTIVITY.—With respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation.

"(B) MEMBERSHIP DUES.—With respect to membership in any club organized for business, pleasure, recreation or other social purposes.

"(C) AMENITY.—With respect to a de minimis fringe (as defined in section 132(e)(1)) that is primarily personal in nature and involving property or services that are not directly related to the taxpayer's trade or business.

"(D) FACILITY.—With respect to a facility or portion thereof used in connection with an activity referred to in subparagraph (A), membership dues or similar amounts referred to in subparagraph (B), or an amenity referred to in subparagraph (C).

"(E) QUALIFIED TRANSPORTATION FRINGE AND PARKING FACILITY.—Which is a qualified transportation fringe (as defined in section 132(f)) or which is a parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)).

"(F) ON-PREMISES ATHLETIC FACILITY.—Which is an on-premises athletic facility as defined in section 132(j)(4)(B).

"(2) SPECIAL RULES.—For purposes of applying paragraph (1), an activity described in section 212 shall be treated as a trade or business.

"(3) REGULATIONS.—Under the regulations prescribed to carry out this section, the Secretary shall include regulations—

"(A) defining entertainment, amenities, recreation, amusement, and facilities for purposes of this subsection,

"(B) providing for the appropriate allocation of depreciation and other costs with respect to facilities used for parking or for on-premises athletic facilities, and

"(C) specifying arrangements a primary purpose of which is the avoidance of this subsection.".

(b) EXCEPTION FOR CERTAIN EXPENSES INCLUDIBLE IN INCOME OF RECIPIENT.—

(1) EXPENSES TREATED AS COMPENSATION.—Paragraph (2) of section 274(e) is amended to read as follows:

"(2) EXPENSES TREATED AS COMPENSATION.—Expenses for goods, services, and facilities, to the extent that the expenses do not exceed the amount of the expenses which are treated by the taxpayer, with respect to the recipient of the entertainment, amusement, or recreation, as compensation to an employee on the taxpayer's return of tax under this chapter and as wages to such employee for purposes of chapter 24 (relating to withholding of income tax at source on wages).".

(2) EXPENSES INCLUDIBLE IN INCOME OF PERSONS WHO ARE NOT EMPLOYEES.—Paragraph (9) of section 274(e) is amended by striking "to the extent that the expenses" and inserting "to the extent that the expenses do not exceed the amount of the expenses that".

(c) EXCEPTIONS FOR REIMBURSED EXPENSES.—Paragraph (3) of section 274(e) is amended to read as follows:

"(3) REIMBURSED EXPENSES.—

"(A) IN GENERAL.—Expenses paid or incurred by the taxpayer, in connection with the performance by him of services for another person (whether or not such other person is the taxpayer's employer), under a reimbursement or other expense allowance arrangement with such other person, but this paragraph shall apply—

"(i) where the services are performed for an employer, only if the employer has not treated such expenses in the manner provided in paragraph (2), or

"(ii) where the services are performed for a person other than an employer, only if the taxpayer accounts (to the extent provided by subsection (d)) to such person.

"(B) EXCEPTION.—Except as provided by the Secretary, subparagraph (A) shall not apply—

"(i) in the case of an arrangement in which the person other than the employer is an entity described in section 168(h)(2)(A), or

"(ii) to any other arrangement designated by the Secretary as having the effect of avoiding the limitation under subparagraph (A).".

(d) 50 PERCENT LIMITATION ON MEALS AND ENTERTAINMENT EXPENSES.—Subsection (n) of section 274 is amended to read as follows:

"(n) LIMITATION ON CERTAIN EXPENSES.—

"(1) IN GENERAL.—The amount allowable as a deduction under this chapter for any expense for food or beverages (pursuant to subsection (e)(1)) or business meals (pursuant to subsection (k)(1)) shall not exceed 50 percent of the amount of such expense or item which would (but for this paragraph) be allowable as a deduction under this chapter.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any expense if—

"(A) such expense is described in paragraph (2), (3), (6), (7), or (8) of subsection (e),

"(B) in the case of an expense for food or beverages, such expense is excludable from the gross income of the recipient under section 132 by reason of subsection (e) thereof (relating to de minimis fringes) or under section 119 (relating to meals and lodging furnished for convenience of employer), or

"(C) in the case of an employer who pays or reimburses moving expenses of an employee, such expenses are includible in the income of the employee under section 82.

"(3) SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.—In the case of any expenses for food or beverages consumed while away from home (within the meaning of section 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, paragraph (1) shall be applied by substituting '80 percent' for '50 percent'.".

(e) CONFORMING AMENDMENTS.—

(1) Section 274(d) is amended—

(A) by striking paragraph (2) and redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively, and

(B) in the flush material following paragraph (3) (as so redesignated)—

(i) by striking ", entertainment, amusement, recreation, or" in item (B), and

(ii) by striking "(D) the business relationship to the taxpayer of persons entertained, using the facility or property, or receiving the gift" and inserting "(D) the business relationship to the taxpayer of the person receiving the benefit".

(2) Section 274(e) is amended by striking paragraph (4) and redesignating paragraphs (5), (6), (7), (8), and (9) as paragraphs (4), (5), (6), (7), and (8), respectively.

(3) Section 274(k)(2)(A) is amended by striking "(4), (7), (8), or (9)" and inserting "(6), (7), or (8)".

(4) Section 274 is amended by striking subsection (l).

(5) Section 274(m)(1)(B)(ii) is amended by striking "(4), (7), (8), or (9)" and inserting "(6), (7), or (8)".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 2017.

SEC. 3308. UNRELATED BUSINESS TAXABLE INCOME INCREASED BY AMOUNT OF CERTAIN FRINGE BENEFIT EXPENSES FOR WHICH DEDUCTION IS DISALLOWED.

(a) IN GENERAL.—Section 512(a) is amended by adding at the end the following new paragraph:

"(6) INCREASE IN UNRELATED BUSINESS TAXABLE INCOME BY DISALLOWED FRINGE.—Unrelated business taxable income of an organization shall be increased by any amount for which a deduction is not allowable under this chapter by reason of section 274 and which is paid or incurred by such organization for any qualified transportation fringe (as defined in section 132(f)), any parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)). The preceding sentence shall not apply to the extent the amount paid or incurred is directly connected with an unrelated trade or business which is regularly carried on by the organization. The Secretary may issue such regulations or other guidance as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations or other guidance providing for the appropriate allocation of depreciation and other costs with respect to facilities used for parking or for on-premises athletic facilities.

".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid or incurred after December 31, 2017.

SEC. 3309. LIMITATION ON DEDUCTION FOR FDIC PREMIUMS.

(a) IN GENERAL.—Section 162 is amended by redesignating subsection (q) as subsection (r) and by inserting after subsection (p) the following new subsection:

"(q) DISALLOWANCE OF FDIC PREMIUMS PAID BY CERTAIN LARGE FINANCIAL INSTITUTIONS.—

"(1) IN GENERAL.—No deduction shall be allowed for the applicable percentage of any FDIC premium paid or incurred by the taxpayer.

"(2) EXCEPTION FOR SMALL INSTITUTIONS.—Paragraph (1) shall not apply to any taxpayer for any taxable year if the total consolidated assets of such taxpayer (determined as of the close of such taxable year) do not exceed $10,000,000,000.

"(3) APPLICABLE PERCENTAGE.—For purposes of this subsection, the term 'applicable percentage' means, with respect to any taxpayer for any taxable year, the ratio (expressed as a percentage but not greater than 100 percent) which—

"(A) the excess of—

"(i) the total consolidated assets of such taxpayer (determined as of the close of such taxable year), over

"(ii) $10,000,000,000, bears to

"(B) $40,000,000,000.

"(4) FDIC PREMIUMS.—For purposes of this subsection, the term 'FDIC premium' means any assessment imposed under section 7(b) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)).

"(5) TOTAL CONSOLIDATED ASSETS.—For purposes of this subsection, the term 'total consolidated assets' has the meaning given such term under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5365).

"(6) AGGREGATION RULE.—

"(A) IN GENERAL.—Members of an expanded affiliated group shall be treated as a single taxpayer for purposes of applying this subsection.

"(B) EXPANDED AFFILIATED GROUP.—For purposes of this paragraph, the term 'expanded affiliated group' means an affiliated group as defined in section 1504(a), determined—

"(i) by substituting 'more than 50 percent' for 'at least 80 percent' each place it appears, and

"(ii) without regard to paragraphs (2) and (3) of section 1504(b).

A partnership or any other entity (other than a corporation) shall be treated as a member of an expanded affiliated group if such entity is controlled (within the meaning of section 954(d)(3)) by members of such group (including any entity treated as a member of such group by reason of this sentence).".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3310. REPEAL OF ROLLOVER OF PUBLICLY TRADED SECURITIES GAIN INTO SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES.

(a) IN GENERAL.—Part III of subchapter O of chapter 1 is amended by striking section 1044 (and by striking the item relating to such section in the table of sections of such part).

(b) CONFORMING AMENDMENTS.—Section 1016(a)(23) is amended—

(1) by striking "1044,", and

(2) by striking "1044(d),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales after December 31, 2017.

SEC. 3311. CERTAIN SELF-CREATED PROPERTY NOT TREATED AS A CAPITAL ASSET.

(a) PATENTS, ETC.—Section 1221(a)(3) is amended by inserting "a patent, invention, model or design (whether or not patented), a secret formula or process," before "a copyright".

(b) CONFORMING AMENDMENT.—Section 1231(b)(1)(C) is amended by inserting "a patent, invention, model or design (whether or not patented), a secret formula or process," before "a copyright".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 2017.

SEC. 3312. REPEAL OF SPECIAL RULE FOR SALE OR EXCHANGE OF PATENTS.

(a) IN GENERAL.—Part IV of subchapter P of chapter 1 is amended by striking section 1235 (and by striking the item relating to such section in the table of sections of such part).

(b) CONFORMING AMENDMENTS.—

(1) Section 483(d) is amended by striking paragraph (4).

(2) Section 901(l)(5) is amended by striking "without regard to section 1235 or any similar rule" and inserting "without regard to any provision which treats a disposition as a sale or exchange of a capital asset held for more than 1 year or any similar provision".

(3) Section 1274(c)(3) is amended by striking subparagraph (E) and redesignating subparagraph (F) as subparagraph (E).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after December 31, 2017.

SEC. 3313. REPEAL OF TECHNICAL TERMINATION OF PARTNERSHIPS.

(a) IN GENERAL.—Paragraph (1) of section 708(b) is amended—

(1) by striking ", or" at the end of subparagraph (A) and all that follows and inserting a period, and

(2) by striking "only if—" and all that follows through "no part of any business" and inserting the following: "only if no part of any business".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years beginning after December 31, 2017.

SEC. 3314. RECHARACTERIZATION OF CERTAIN GAINS IN THE CASE OF PARTNERSHIP PROFITS INTERESTS HELD IN CONNECTION WITH PERFORMANCE OF INVESTMENT SERVICES.

(a) IN GENERAL.—Part IV of subchapter O of chapter 1 is amended—

(1) by redesignating section 1061 as section 1062, and

(2) by inserting after section 1060 the following new section:

"SEC. 1061. PARTNERSHIP INTERESTS HELD IN CONNECTION WITH PERFORMANCE OF SERVICES.

"(a) IN GENERAL.—If one or more applicable partnership interests are held by a taxpayer at any time during the taxable year, the excess (if any) of—

"(1) the taxpayer's net long-term capital gain with respect to such interests for such taxable year, over

"(2) the taxpayer's net long-term capital gain with respect to such interests for such taxable year computed by applying paragraphs (3) and (4) of sections 1222 by substituting '3 years' for '1 year',

shall be treated as short-term capital gain.

"(b) SPECIAL RULE.—To the extent provided by the Secretary, subsection (a) shall not apply to income or gain attributable to any asset not held for portfolio investment on behalf of third party investors.

"(c) APPLICABLE PARTNERSHIP INTEREST.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in this paragraph or paragraph (4), the term 'applicable partnership interest' means any interest in a partnership which, directly or indirectly, is transferred to (or is held by) the taxpayer in connection with the performance of substantial services by the taxpayer, or any other related person, in any applicable trade or business. The previous sentence shall not apply to an interest held by a person who is employed by another entity that is conducting a trade or business (other than an applicable trade or business) and only provides services to such other entity.

"(2) APPLICABLE TRADE OR BUSINESS.—The term 'applicable trade or business' means any activity conducted on a regular, continuous, and substantial basis which, regardless of whether the activity is conducted in one or more entities, consists, in whole or in part, of—

"(A) raising or returning capital, and

"(B) either—

"(i) investing in (or disposing of) specified assets (or identifying specified assets for such investing or disposition), or

"(ii) developing specified assets.

"(3) SPECIFIED ASSET.—The term 'specified asset' means securities (as defined in section 475(c)(2) without regard to the last sentence thereof), commodities (as defined in section 475(e)(2)), real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to any of the foregoing, and an interest in a partnership to the extent of the partnership's proportionate interest in any of the foregoing.

"(4) EXCEPTIONS.—The term 'applicable partnership interest' shall not include—

"(A) any interest in a partnership directly or indirectly held by a corporation, or

"(B) any capital interest in the partnership which provides the taxpayer with a right to share in partnership capital commensurate with—

"(i) the amount of capital contributed (determined at the time of receipt of such partnership interest), or

"(ii) the value of such interest subject to tax under section 83 upon the receipt or vesting of such interest.

"(5) THIRD PARTY INVESTOR.—The term 'third party investor' means a person who—

"(A) holds an interest in the partnership which does not constitute property held in connection with an applicable trade or business; and

"(B) is not (and has not been) actively engaged, and is (and was) not related to a person so engaged, in (directly or indirectly) providing substantial services described in paragraph (1) for such partnership or any applicable trade or business.

"(d) TRANSFER OF APPLICABLE PARTNERSHIP INTEREST TO RELATED PERSON.—

"(1) IN GENERAL.—If a taxpayer transfers any applicable partnership interest, directly or indirectly, to a person related to the taxpayer, the taxpayer shall include in gross income (as short term capital gain) the excess (if any) of—

"(A) so much of the taxpayer's long-term capital gains with respect to such interest for such taxable year attributable to the sale or exchange of any asset held for not more than 3 years as is allocable to such interest, over

"(B) any amount treated as short term capital gain under subsection (a) with respect to the transfer of such interest.

"(2) RELATED PERSON.—For purposes of this paragraph, a person is related to the taxpayer if—

"(A) the person is a member of the taxpayer's family within the meaning of section 318(a)(1), or

"(B) the person performed a service within the current calendar year or the preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.

"(e) REPORTING.—The Secretary shall require such reporting (at the time and in the manner prescribed by the Secretary) as is necessary to carry out the purposes of this section.

"(f) REGULATIONS.—The Secretary shall issue such regulations or other guidance as is necessary or appropriate to carry out the purposes of this section".

(b) COORDINATION WITH SECTION 83.—Subsection (e) of section 83 is amended by striking "or" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", or", and by adding at the end the following new paragraph:

"(6) a transfer of an applicable partnership interest to which section 1061 applies.".

(c) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to 1061 and inserting the following new items:

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3315. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) IN GENERAL.—Section 174 is amended to read as follows:

"SEC. 174. AMORTIZATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

"(a) IN GENERAL.—In the case of a taxpayer's specified research or experimental expenditures for any taxable year—

"(1) except as provided in paragraph (2), no deduction shall be allowed for such expenditures, and

"(2) the taxpayer shall—

"(A) charge such expenditures to capital account, and

"(B) be allowed an amortization deduction of such expenditures ratably over the 5-year period (15-year period in the case of any specified research or experimental expenditures which are attributable to foreign research (within the meaning of section 41(d)(4)(F))) beginning with the midpoint of the taxable year in which such expenditures are paid or incurred.

"(b) SPECIFIED RESEARCH OR EXPERIMENTAL EXPENDITURES.—For purposes of this section, the term 'specified research or experimental expenditures' means, with respect to any taxable year, research or experimental expenditures which are paid or incurred by the taxpayer during such taxable year in connection with the taxpayer's trade or business.

"(c) SPECIAL RULES.—

"(1) LAND AND OTHER PROPERTY.—This section shall not apply to any expenditure for the acquisition or improvement of land, or for the acquisition or improvement of property to be used in connection with the research or experimentation and of a character which is subject to the allowance under section 167 (relating to allowance for depreciation, etc.) or section 611 (relating to allowance for depletion); but for purposes of this section allowances under section 167, and allowances under section 611, shall be considered as expenditures.

"(2) EXPLORATION EXPENDITURES.—This section shall not apply to any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

"(3) SOFTWARE DEVELOPMENT.—For purposes of this section, any amount paid or incurred in connection with the development of any software shall be treated as a research or experimental expenditure.

"(d) TREATMENT UPON DISPOSITION, RETIREMENT, OR ABANDONMENT.—If any property with respect to which specified research or experimental expenditures are paid or incurred is disposed, retired, or abandoned during the period during which such expenditures are allowed as an amortization deduction under this section, no deduction shall be allowed with respect to such expenditures on account of such disposition, retirement, or abandonment and such amortization deduction shall continue with respect to such expenditures.".

(b) CLERICAL AMENDMENT.—The table of sections for part VI of subchapter B of chapter 1 is amended by striking the item relating to section 174 and inserting the following new item:

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2022.

SEC. 3316. UNIFORM TREATMENT OF EXPENSES IN CONTINGENCY FEE CASES.

(a) IN GENERAL.—Section 162, as amended by the preceding provisions of this Act, is amended by redesignating subsection (r) as subsection (s) and by inserting after subsection (q) the following new subsection:

"(r) EXPENSES IN CONTINGENCY FEE CASES.—No deduction shall be allowed under subsection (a) to a taxpayer for any expense—

"(1) paid or incurred in the course of the trade or business of practicing law, and

"(2) resulting from a case for which the taxpayer is compensated primarily on a contingent basis,

until such time as such contingency is resolved.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenses and costs paid or incurred in taxable years beginning after the date of the enactment of this Act.

Subtitle E—Reform of Business Credits

SEC. 3401. REPEAL OF CREDIT FOR CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 is amended by striking section 45C (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1) Section 38(b) is amended by striking paragraph (12).

(2) Section 280C is amended by striking subsection (b).

(3) Section 6501(m) is amended by striking "45C(d)(4),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2017.

SEC. 3402. REPEAL OF EMPLOYER-PROVIDED CHILD CARE CREDIT.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 is amended by striking section 45F (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1) Section 38(b) is amended by striking paragraph (15).

(2) Section 1016(a) is amended by striking paragraph (28).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(2) BASIS ADJUSTMENTS.—The amendment made by subsection (b)(2) shall apply to credits determined for taxable years beginning after December 31, 2017.

SEC. 3403. REPEAL OF REHABILITATION CREDIT.

(a) IN GENERAL.—Subpart E of part IV of subchapter A of chapter 1 is amended by striking section 47 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1) Section 170(f)(14)(A) is amended by inserting "(as in effect before its repeal by the Tax Cuts and Jobs Act)" after "section 47".

(2) Section 170(h)(4) is amended—

(A) by striking "(as defined in section 47(c)(3)(B))" in subparagraph (C)(ii), and

(B) by adding at the end the following new subparagraph:

"(D) REGISTERED HISTORIC DISTRICT.—The term 'registered historic district' means—

"(i) any district listed in the National Register, and

"(ii) any district—

"(I) which is designated under a statute of the appropriate State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and

"(II) which is certified by the Secretary of the Interior to the Secretary as meeting substantially all of the requirements for the listing of districts in the National Register.".

(3) Section 469(i)(3) is amended by striking subparagraph (B).

(4) Section 469(i)(6)(B) is amended—

(A) by striking "in the case of—" and all that follows and inserting "in the case of any credit determined under section 42 for any taxable year.", and

(B) by striking ", REHABILITATION CREDIT," in the heading thereof.

(5) Section 469(k)(1) is amended by striking ", or any rehabilitation credit determined under section 47,".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts paid or incurred after December 31, 2017.

(2) TRANSITION RULE.—In the case of qualified rehabilitation expenditures (within the meaning of section 47 of the Internal Revenue Code of 1986 as in effect before its repeal) with respect to any building—

(A) owned or leased (as permitted by section 47 of the Internal Revenue Code of 1986 as in effect before its repeal) by the taxpayer at all times after December 31, 2017, and

(B) with respect to which the 24-month period selected by the taxpayer under section 47(c)(1)(C) of such Code begins not later than the end of the 180-day period beginning on the date of the enactment of this Act,

the amendments made by this section shall apply to such expenditures paid or incurred after the end of the taxable year in which the 24-month period referred to in subparagraph (B) ends.

SEC. 3404. REPEAL OF WORK OPPORTUNITY TAX CREDIT.

(a) IN GENERAL.—Subpart F of part IV of subchapter A of chapter 1 is amended by striking section 51 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CLERICAL AMENDMENT.—The heading of such subpart F (and the item relating to such subpart in the table of subparts for part IV of subchapter A of chapter 1) are each amended by striking "Rules for Computing Work Opportunity Credit" and inserting "Special Rules".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred to individuals who begin work for the employer after December 31, 2017.

SEC. 3405. REPEAL OF DEDUCTION FOR CERTAIN UNUSED BUSINESS CREDITS.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 is amended by striking section 196 (and by striking the item relating to such section in the table of sections for such part).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3406. TERMINATION OF NEW MARKETS TAX CREDIT.

(a) IN GENERAL.—Section 45D(f) is amended—

(1) by striking "2019" in paragraph (1)(G) and inserting "2017", and

(2) by striking "2024" in paragraph (3) and inserting "2022".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years beginning after December 31, 2017.

SEC. 3407. REPEAL OF CREDIT FOR EXPENDITURES TO PROVIDE ACCESS TO DISABLED INDIVIDUALS.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 is amended by striking section 44 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENT.—Section 38(b) is amended by striking paragraph (7).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3408. MODIFICATION OF CREDIT FOR PORTION OF EMPLOYER SOCIAL SECURITY TAXES PAID WITH RESPECT TO EMPLOYEE TIPS.

(a) CREDIT DETERMINED WITH RESPECT TO MINIMUM WAGE AS IN EFFECT.—Section 45B(b)(1)(B) is amended by striking "as in effect on January 1, 2007, and".

(b) INFORMATION RETURN REQUIREMENT.—Section 45B is amended by redesignating subsections (c) and (d) as subsections (d) and (e), respectively, and by inserting after subsection (b) the following new subsection:

"(c) INFORMATION RETURN REQUIREMENT.—

"(1) IN GENERAL.—No credit shall be determined under subsection (a) with respect to any food or beverage establishment of any taxpayer for any taxable year unless such taxpayer has, with respect to the calendar year which ends in or with such taxable year—

"(A) made a report to the Secretary showing the information described in section 6053(c)(1) with respect to such food or beverage establishment, and

"(B) furnished written statements to each employee of such food or beverage establishment showing the information described in section 6053(c)(2).

"(2) ALLOCATION OF 10 PERCENT OF GROSS RECEIPTS.—For purposes of determining the information referred to in subparagraphs (A) and (B), section 6053(c)(3)(A)(i) shall be applied by substituting '10 percent' for '8 percent'. For purposes of section 6053(c)(5), any reference to section 6053(c)(3)(B) contained therein shall be treated as including a reference to this paragraph.

"(3) FOOD OR BEVERAGE ESTABLISHMENT.—For purposes of this subsection, the term 'food or beverage establishment' means any trade or business (or portion thereof) which would be a large food or beverage establishment (as defined in section 6053(c)(4)) if such section were applied without regard to subparagraph (C) thereof.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle F—Energy Credits

SEC. 3501. MODIFICATIONS TO CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES.

(a) TERMINATION OF INFLATION ADJUSTMENT.—Section 45(b)(2) is amended—

(1) by striking "The 1.5 cent amount" and inserting the following:

"(A) IN GENERAL.—The 1.5 cent amount", and

(2) by adding at the end the following new subparagraph:

"(B) TERMINATION.—Subparagraph (A) shall not apply with respect to any electricity or refined coal produced at a facility the construction of which begins after the date of the enactment of this subparagraph.".

(b) SPECIAL RULE FOR DETERMINATION OF BEGINNING OF CONSTRUCTION.—Section 45(e) is amended by adding at the end the following new paragraph:

"(12) SPECIAL RULE FOR DETERMINING BEGINNING OF CONSTRUCTION.—For purposes of subsection (d), the construction of any facility, modification, improvement, addition, or other property shall 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.".

(c) EFFECTIVE DATES.—

(1) TERMINATION OF INFLATION ADJUSTMENT.—The amendments made by subsection (a) shall apply to taxable years ending after the date of the enactment of this Act.

(2) SPECIAL RULE FOR DETERMINATION OF BEGINNING OF CONSTRUCTION.—The amendment made by subsection (b) shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

SEC. 3502. MODIFICATION OF THE ENERGY INVESTMENT TAX CREDIT.

(a) EXTENSION OF SOLAR ENERGY PROPERTY.—Section 48(a)(3)(A)(ii) is amended by striking "periods ending before January 1, 2017" and inserting "property the construction of which begins before January 1, 2022".

(b) EXTENSION OF QUALIFIED FUEL CELL PROPERTY.—Section 48(c)(1)(D) is amended by striking "for any period after December 31, 2016" and inserting "the construction of which does not begin before January 1, 2022".

(c) EXTENSION OF QUALIFIED MICROTURBINE PROPERTY.—Section 48(c)(2)(D) is amended by striking "for any period after December 31, 2016" and inserting "the construction of which does not begin before January 1, 2022".

(d) EXTENSION OF COMBINED HEAT AND POWER SYSTEM PROPERTY.—Section 48(c)(3)(A)(iv) is amended by striking "which is placed in service before January 1, 2017" and inserting "the construction of which begins before January 1, 2022".

(e) EXTENSION OF QUALIFIED SMALL WIND ENERGY PROPERTY.—Section 48(c)(4)(C) is amended by striking "for any period after December 31, 2016" and inserting "the construction of which does not begin before January 1, 2022".

(f) EXTENSION OF THERMAL ENERGY PROPERTY.—Section 48(a)(3)(A)(vii) is amended by striking "periods ending before January 1, 2017" and inserting "property the construction of which begins before January 1, 2022".

(g) PHASEOUT OF 30 PERCENT CREDIT RATE FOR FUEL CELL AND SMALL WIND ENERGY PROPERTY.—Section 48(a) is amended by adding at the end the following new paragraph:

"(7) PHASEOUT FOR QUALIFIED FUEL CELL PROPERTY AND QUALIFIED SMALL WIND ENERGY PROPERTY.—

"(A) IN GENERAL.—In the case of qualified fuel cell property or qualified small wind energy property, the construction of which begins before January 1, 2022, the energy percentage determined under paragraph (2) shall be equal to—

"(i) in the case of any property the construction of which begins after December 31, 2019, and before January 1, 2021, 26 percent, and

"(ii) in the case of any property the construction of which begins after December 31, 2020, and before January 1, 2022, 22 percent.

"(B) PLACED IN SERVICE DEADLINE.—In the case of any qualified fuel cell property or qualified small wind energy property, the construction of which begins before January 1, 2022, and which is not placed in service before January 1, 2024, the energy percentage determined under paragraph (2) shall be equal to 10 percent.".

(h) PHASEOUT FOR FIBER-OPTIC SOLAR ENERGY PROPERTY.—Subparagraphs (A) and (B) of section 48(a)(6) are each amended by inserting "or (3)(A)(ii)" after "paragraph (3)(A)(i)".

(i) TERMINATION OF SOLAR ENERGY PROPERTY.—Section 48(a)(3)(A)(i) is amended by inserting ", the construction of which begins before January 1, 2028, and" after "equipment".

(j) TERMINATION OF GEOTHERMAL ENERGY PROPERTY.—Section 48(a)(3)(A)(iii) is amended by inserting ", the construction of which begins before January 1, 2028, and" after "equipment".

(k) SPECIAL RULE FOR DETERMINATION OF BEGINNING OF CONSTRUCTION.—Section 48(c) is amended by adding at the end the following new paragraph:

"(5) SPECIAL RULE FOR DETERMINING BEGINNING OF CONSTRUCTION.—The construction of any facility, modification, improvement, addition, or other property shall 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.".

(l) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to periods after December 31, 2016, under rules similar to the rules of section 48(m) of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).

(2) EXTENSION OF COMBINED HEAT AND POWER SYSTEM PROPERTY.—The amendment made by subsection (d) shall apply to property placed in service after December 31, 2016.

(3) PHASEOUTS AND TERMINATIONS.—The amendments made by subsections (g), (h), (i), and (j) shall take effect on the date of the enactment of this Act.

(4) SPECIAL RULE FOR DETERMINATION OF BEGINNING OF CONSTRUCTION.—The amendment made by subsection (k) shall apply to taxable years beginning before, on, or after the date of the enactment of this Act.

SEC. 3503. EXTENSION AND PHASEOUT OF RESIDENTIAL ENERGY EFFICIENT PROPERTY.

(a) EXTENSION.—Section 25D(h) is amended by striking "December 31, 2016 (December 31, 2021, in the case of any qualified solar electric property expenditures and qualified solar water heating property expenditures)" and inserting "December 31, 2021".

(b) PHASEOUT.—

(1) IN GENERAL.—Paragraphs (3), (4), and (5) of section 25D(a) are amended by striking "30 percent" each place it appears and inserting "the applicable percentage".

(2) CONFORMING AMENDMENT.—Section 25D(g) of such Code is amended by striking "paragraphs (1) and (2) of".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2016.

SEC. 3504. REPEAL OF ENHANCED OIL RECOVERY CREDIT.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 is amended by striking section 43 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENTS.—

(1) Section 38(b) is amended by striking paragraph (6).

(2) Section 6501(m) is amended by striking "43,".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3505. REPEAL OF CREDIT FOR PRODUCING OIL AND GAS FROM MARGINAL WELLS.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 is amended by striking section 45I (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENT.—Section 38(b) is amended by striking paragraph (19).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3506. MODIFICATIONS OF CREDIT FOR PRODUCTION FROM ADVANCED NUCLEAR POWER FACILITIES.

(a) TREATMENT OF UNUTILIZED LIMITATION AMOUNTS.—Section 45J(b) is amended—

(1) in paragraph (4), by inserting "or any amendment to" after "enactment of"; and

(2) by adding at the end the following new paragraph:

"(5) ALLOCATION OF UNUTILIZED LIMITATION.—

"(A) IN GENERAL.—Any unutilized national megawatt capacity limitation shall be allocated by the Secretary under paragraph (3) as rapidly as is practicable after December 31, 2020—

"(i) first to facilities placed in service on or before such date to the extent that such facilities did not receive an allocation equal to their full nameplate capacity; and

"(ii) then to facilities placed in service after such date in the order in which such facilities are placed in service.

"(B) UNUTILIZED NATIONAL MEGAWATT CAPACITY LIMITATION.—The term 'unutilized national megawatt capacity limitation' means the excess (if any) of—

"(i) 6,000 megawatts, over

"(ii) the aggregate amount of national megawatt capacity limitation allocated by the Secretary before January 1, 2021, reduced by any amount of such limitation which was allocated to a facility which was not placed in service before such date.

"(C) COORDINATION WITH OTHER PROVISIONS.—In the case of any unutilized national megawatt capacity limitation allocated by the Secretary pursuant to this paragraph—

"(i) such allocation shall be treated for purposes of this section in the same manner as an allocation of national megawatt capacity limitation; and

"(ii) subsection (d)(1)(B) shall not apply to any facility which receives such allocation.".

(b) TRANSFER OF CREDIT BY CERTAIN PUBLIC ENTITIES.—

(1) IN GENERAL.—Section 45J is amended—

(A) by redesignating subsection (e) as subsection (f); and

(B) by inserting after subsection (d) the following new subsection:

"(e) TRANSFER OF CREDIT BY CERTAIN PUBLIC ENTITIES.—

"(1) IN GENERAL.—If, with respect to a credit under subsection (a) for any taxable year—

"(A) the taxpayer would be a qualified public entity; and

"(B) such entity elects the application of this paragraph for such taxable year with respect to all (or any portion specified in such election) of such credit,

the eligible project partner specified in such election (and not the qualified public entity) shall be treated as the taxpayer for purposes of this title with respect to such credit (or such portion thereof).

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) QUALIFIED PUBLIC ENTITY.—The term 'qualified public entity' means—

"(i) a Federal, State, or local government entity, or any political subdivision, agency, or instrumentality thereof;

"(ii) a mutual or cooperative electric company described in section 501(c)(12) or section 1381(a)(2); or

"(iii) a not-for-profit electric utility which has or had received a loan or loan guarantee under the Rural Electrification Act of 1936.

"(B) ELIGIBLE PROJECT PARTNER.—The term 'eligible project partner' means—

"(i) any person responsible for, or participating in, the design or construction of the advanced nuclear power facility to which the credit under subsection (a) relates;

"(ii) any person who participates in the provision of the nuclear steam supply system to the advanced nuclear power facility to which the credit under subsection (a) relates;

"(iii) any person who participates in the provision of nuclear fuel to the advanced nuclear power facility to which the credit under subsection (a) relates; or

"(iv) any person who has an ownership interest in such facility.

"(3) SPECIAL RULES.—

"(A) APPLICATION TO PARTNERSHIPS.—In the case of a credit under subsection (a) which is determined at the partnership level—

"(i) for purposes of paragraph (1)(A), a qualified public entity shall be treated as the taxpayer with respect to such entity's distributive share of such credit; and

"(ii) the term 'eligible project partner' shall include any partner of the partnership.

"(B) TAXABLE YEAR IN WHICH CREDIT TAKEN INTO ACCOUNT.—In the case of any credit (or portion thereof) with respect to which an election is made under paragraph (1), such credit shall be taken into account in the first taxable year of the eligible project partner ending with, or after, the qualified public entity's taxable year with respect to which the credit was determined.

"(C) TREATMENT OF TRANSFER UNDER PRIVATE USE RULES.—For purposes of section 141(b)(1), any benefit derived by an eligible project partner in connection with an election under this subsection shall not be taken into account as a private business use.".

(2) SPECIAL RULE FOR PROCEEDS OF TRANSFERS FOR MUTUAL OR COOPERATIVE ELECTRIC COMPANIES.—Section 501(c)(12) of such Code is amended by adding at the end the following new subparagraph:

"(I) In the case of a mutual or cooperative electric company described in this paragraph or an organization described in section 1381(a)(2), income received or accrued in connection with an election under section 45J(e)(1) shall be treated as an amount collected from members for the sole purpose of meeting losses and expenses.".

(c) EFFECTIVE DATES.—

(1) TREATMENT OF UNUTILIZED LIMITATION AMOUNTS.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

(2) TRANSFER OF CREDIT BY CERTAIN PUBLIC ENTITIES.—The amendments made by subsection (b) shall apply to taxable years beginning after the date of the enactment of this Act.

Subtitle G—Bond Reforms

SEC. 3601. TERMINATION OF PRIVATE ACTIVITY BONDS.

(a) IN GENERAL.—Paragraph (1) of section 103(b) is amended—

(1) by striking "which is not a qualified bond (within the meaning of section 141)", and

(2) by striking "WHICH IS NOT A QUALIFIED BOND" in the heading thereof.

(b) CONFORMING AMENDMENTS.—

(1) Subpart A of part IV of subchapter B of chapter 1 is amended by striking sections 142, 143, 144, 145, 146, and 147 (and by striking each of the items relating to such sections in the table of sections for such subpart).

(2) Section 25 is amended by adding at the end the following new subsection:

"(j) COORDINATION WITH REPEAL OF PRIVATE ACTIVITY BONDS.—Any reference to section 143, 144, or 146 shall be treated as a reference to such section as in effect before its repeal by the Tax Cuts and Jobs Act.".

(3) Section 26(b)(2) is amended by striking subparagraph (D).

(4) Section 141(b) is amended by striking paragraphs (5) and (9).

(5) Section 141(d) is amended by striking paragraph (5).

(6) Section 141 is amended by striking subsection (e).

(7) Section 148(f)(4) is amended—

(A) by striking "(determined in accordance with section 147(b)(2)(A))" in the flush matter following subparagraph (A)(ii) and inserting "(determined by taking into account the respective issue prices of the bonds issued as part of the issue)", and

(B) by striking the last sentence of subparagraph (D)(v).

(8) Clause (iv) of section 148(f)(4)(C) is amended to read as follows:

"(iv) CONSTRUCTION ISSUE.—For purposes of this subparagraph—

"(I) IN GENERAL.—The term 'construction issue' means any issue if at least 75 percent of the available construction proceeds of such issue are to be used for construction expenditures.

"(II) CONSTRUCTION.—The term 'construction' includes reconstruction and rehabilitation.".

(9) Section 149(b)(3) is amended by striking subparagraph (C).

(10) Section 149(e)(2) is amended—

(A) by striking subparagraphs (C), (D), and (F) and by redesignating subparagraphs (E) and (G) as subparagraphs (C) and (D), respectively, and

(B) by striking the second sentence.

(11) Section 149(f)(6) is amended—

(A) by striking subparagraph (B), and

(B) by striking "For purposes of this subsection" and all that follows through "The term" and inserting the following: "For purposes of this subsection, the term".

(12) Section 150(e)(3) is amended to read as follows:

"(3) PUBLIC APPROVAL REQUIREMENT.—A bond shall not be treated as part of an issue which meets the requirements of paragraph (1) unless such bond satisfies the requirements of section 147(f)(2) (as in effect before its repeal by the Tax Cuts and Jobs Act).".

(13) Section 269A(b)(3) is amended by striking "144(a)(3)" and inserting "414(n)(6)(A)".

(14) Section 414(m)(5) is amended by striking "section 144(a)(3)" and inserting "subsection (n)(6)(A)".

(15) Section 414(n)(6)(A) is amended to read as follows:

"(A) RELATED PERSONS.—A person is a related person to another person if—

"(i) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

"(ii) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears therein).".

(16) Section 6045(e)(4)(B) is amended by inserting "(as in effect before its repeal by the Tax Cuts and Jobs Act)" after "section 143(m)(3)".

(17) Section 6654(f)(1) is amended by inserting "(as in effect before its repeal by the Tax Cuts and Jobs Act)" after "section 143(m)".

(18) Section 7871(c) is amended—

(A) by striking paragraphs (2) and (3), and

(B) by striking "TAX-EXEMPT BONDS.—" and all that follows through "Subsection (a) of section 103" and inserting the following: "TAX-EXEMPT BONDS.—Subsection (a) of section 103".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after December 31, 2017.

SEC. 3602. REPEAL OF ADVANCE REFUNDING BONDS.

(a) IN GENERAL.—Paragraph (1) of section 149(d) is amended by striking "as part of an issue described in paragraph (2), (3), or (4)." and inserting "to advance refund another bond.".

(b) CONFORMING AMENDMENTS.—

(1) Section 149(d) is amended by striking paragraphs (2), (3), (4), and (6) and by redesignating paragraphs (5) and (7) as paragraphs (2) and (3).

(2) Section 148(f)(4)(C) is amended by striking clause (xiv) and by redesignating clauses (xv) to (xvii) as clauses (xiv) to (xvi).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to advance refunding bonds issued after December 31, 2017.

SEC. 3603. REPEAL OF TAX CREDIT BONDS.

(a) IN GENERAL.—Part IV of subchapter A of chapter 1 is amended by striking subparts H, I, and J (and by striking the items relating to such subparts in the table of subparts for such part).

(b) PAYMENTS TO ISSUERS.—Subchapter B of chapter 65 is amended by striking section 6431 (and by striking the item relating to such section in the table of sections for such subchapter).

(c) CONFORMING AMENDMENTS.—

(1) Part IV of subchapter U of chapter 1 is amended by striking section 1397E (and by striking the item relating to such section in the table of sections for such part).

(2) Section 54(l)(3)(B) is amended by inserting "(as in effect before its repeal by the Tax Cuts and Jobs Act)" after "section 1397E(I)".

(3) Section 6211(b)(4)(A) is amended by striking ", and 6431" and inserting "and" before "36B".

(4) Section 6401(b)(1) is amended by striking "G, H, I, and J" and inserting "and G".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after December 31, 2017.

SEC. 3604. NO TAX EXEMPT BONDS FOR PROFESSIONAL STADIUMS.

(a) IN GENERAL.—Section 103(b), as amended by this Act, is further amended by adding at the end the following new paragraph:

"(4) PROFESSIONAL STADIUM BOND.—Any professional stadium bond.".

(b) PROFESSIONAL STADIUM BOND DEFINED.—Subsection (c) of section 103 is amended by adding at the end the following new paragraph:

"(3) PROFESSIONAL STADIUM BOND.—The term 'professional stadium bond' means any bond issued as part of an issue any proceeds of which are used to finance or refinance capital expenditures allocable to a facility (or appurtenant real property) which, during at least 5 days during any calendar year, is used as a stadium or arena for professional sports exhibitions, games, or training.''.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after November 2, 2017.

Subtitle H—Insurance

SEC. 3701. NET OPERATING LOSSES OF LIFE INSURANCE COMPANIES.

(a) IN GENERAL.—Section 805(b) is amended by striking paragraph (4) and by redesignating paragraph (5) as paragraph (4).

(b) CONFORMING AMENDMENTS.—

(1) Part I of subchapter L of chapter 1 is amended by striking section 810 (and by striking the item relating to such section in the table of sections for such part).

(2) Part III of subchapter L of chapter 1 is amended by striking section 844 (and by striking the item relating to such section in the table of sections for such part).

(3) Section 381 is amended by striking subsection (d).

(4) Section 805(a)(4)(B)(ii) is amended to read as follows:

''(ii) the deduction allowed under section 172,''.

(5) Section 805(a) is amended by striking paragraph (5).

(6) Section 953(b)(1)(B) is amended to read as follows:

''(B) So much of section 805(a)(8) as relates to the deduction allowed under section 172.''.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to losses arising in taxable years beginning after December 31, 2017.

SEC. 3702. REPEAL OF SMALL LIFE INSURANCE COMPANY DEDUCTION.

(a) IN GENERAL.—Part I of subchapter L of chapter 1 is amended by striking section 806 (and by striking the item relating to such section in the table of sections for such part).

(b) CONFORMING AMENDMENTS.—

(1) Section 453B(e) is amended—

(A) by striking ''(as defined in section 806(b)(3))'' in paragraph (2)(B), and

(B) by adding at the end the following new paragraph:

''(3) NONINSURANCE BUSINESS.—

''(A) IN GENERAL.—For purposes of this subsection, the term 'noninsurance business' means any activity which is not an insurance business.

''(B) CERTAIN ACTIVITIES TREATED AS INSURANCE BUSINESSES.—For purposes of subparagraph (A), any activity which is not an insurance business shall be treated as an insurance business if—

''(i) it is of a type traditionally carried on by life insurance companies for investment purposes, but only if the carrying on of such activity (other than in the case of real estate) does not constitute the active conduct of a trade or business, or

''(ii) it involves the performance of administrative services in connection with plans providing life insurance, pension, or accident and health benefits.''.

(2) Section 465(c)(7)(D)(v)(II) is amended by striking ''section 806(b)(3)'' and inserting ''section 453B(e)(3)''.

(3) Section 801(a)(2) is amended by striking subparagraph (C).

(4) Section 804 is amended by striking ''means—'' and all that follows and inserting ''means the general deductions provided in section 805.''.

(5) Section 805(a)(4)(B), as amended by section 3701, is amended by striking clause (i) and by redesignating clauses (ii), (iii), and (iv) as clauses (i), (ii), and (iii), respectively.

(6) Section 805(b)(2)(A) is amended by striking clause (iii) and by redesignating clauses (iv) and (v) as clauses (iii) and (iv), respectively.

(7) Section 842(c) is amended by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(8) Section 953(b)(1), as amended by section 3701, is amended by striking subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3703. SURTAX ON LIFE INSURANCE COMPANY TAXABLE INCOME.

(a) IN GENERAL.—Section 801(a)(1) is amended—

(1) by striking "consist of a tax" and insert "consist of the sum of—

"(A) a tax", and

(2) by striking the period at the end and inserting ", and", and

(3) by adding at the end the following new subparagraph:

"(B) a tax equal to 8 percent of the life insurance company taxable income.".

SEC. 3704. ADJUSTMENT FOR CHANGE IN COMPUTING RESERVES.

(a) IN GENERAL.—Paragraph (1) of section 807(f) is amended to read as follows:

"(1) TREATMENT AS CHANGE IN METHOD OF ACCOUNTING.—If the basis for determining any item referred to in subsection (c) as of the close of any taxable year differs from the basis for such determination as of the close of the preceding taxable year, then so much of the difference between—

"(A) the amount of the item at the close of the taxable year, computed on the new basis, and

"(B) the amount of the item at the close of the taxable year, computed on the old basis,

as is attributable to contracts issued before the taxable year shall be taken into account under section 481 as adjustments attributable to a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3705. REPEAL OF SPECIAL RULE FOR DISTRIBUTIONS TO SHAREHOLDERS FROM PRE-1984 POLICYHOLDERS SURPLUS ACCOUNT.

(a) IN GENERAL.—Subpart D of part I of subchapter L is amended by striking section 815 (and by striking the item relating to such section in the table of sections for such subpart).

(b) CONFORMING AMENDMENT.—Section 801 is amended by striking subsection (c).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(d) PHASED INCLUSION OF REMAINING BALANCE OF POLICYHOLDERS SURPLUS ACCOUNTS.—In the case of any stock life insurance company which has a balance (determined as of the close of such company's last taxable year beginning before January 1, 2018) in an existing policyholders surplus account (as defined in section 815 of the Internal Revenue Code of 1986, as in effect before its repeal), the tax imposed by section 801 of such Code for the first 8 taxable years beginning after December 31, 2017, shall be the amount which would be imposed by such section for such year on the sum of—

(1) life insurance company taxable income for such year (within the meaning of such section 801 but not less than zero), plus

(2) ⅛ of such balance.

SEC. 3706. MODIFICATION OF PRORATION RULES FOR PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) IN GENERAL.—Section 832(b)(5)(B) is amended by striking "15 percent" and inserting "26.25 percent".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3707. MODIFICATION OF DISCOUNTING RULES FOR PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) MODIFICATION OF RATE OF INTEREST USED TO DISCOUNT UNPAID LOSSES.—Paragraph (2) of section 846(c) is amended to read as follows:

"(2) DETERMINATION OF ANNUAL RATE.—The annual rate determined by the Secretary under this paragraph for any calendar year shall be a rate determined on the basis of the corporate bond yield curve (as defined in section 430(h)(2)(D)(i)).".

(b) MODIFICATION OF COMPUTATIONAL RULES FOR LOSS PAYMENT PATTERNS.—Section 846(d)(3) is amended by striking subparagraphs (B) through (G) and inserting the following new subparagraphs:

"(B) TREATMENT OF CERTAIN LOSSES.—Losses which would have been treated as paid in the last year of the period applicable under subparagraph (A)(i) or (A)(ii) shall be treated as paid in the following manner:

"(i) 3-YEAR LOSS PAYMENT PATTERN.—

"(I) IN GENERAL.—The period taken into account under subparagraph (A)(i) shall be extended to the extent required under subclause (II).

"(II) COMPUTATION OF EXTENSION.—The amount of losses which would have been treated as paid in the 3d year after the accident year shall be treated as paid in such 3d year and each subsequent year in an amount equal to the average of the losses treated as paid in the 1st and 2d years after the accident year (or, if lesser, the portion of the unpaid losses not theretofore taken into account). To the extent such unpaid losses have not been treated as paid before the 18th year after the accident year, they shall be treated as paid in such 18th year.

"(ii) 10-YEAR LOSS PAYMENT PATTERN.—

"(I) IN GENERAL.—The period taken into account under subparagraph (A)(ii) shall be extended to the extent required under subclause (II).

"(II) COMPUTATION OF EXTENSION.—The amount of losses which would have been treated as paid in the 10th year after the accident year shall be treated as paid in such 10th year and each subsequent year in an amount equal to the amount of the average of the losses treated as paid in the 7th, 8th, and 9th years after the accident year (or, if lesser, the portion of the unpaid losses not theretofore taken into account). To the extent such unpaid losses have not been treated as paid before the 25th year after the accident year, they shall be treated as paid in such 25th year.".

(c) REPEAL OF HISTORICAL PAYMENT PATTERN ELECTION.—Section 846 is amended by striking subsection (e) and by redesignating subsections (f) and (g) as subsections (e) and (f), respectively.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

(e) TRANSITIONAL RULE.—For the first taxable year beginning after December 31, 2017—

(1) the unpaid losses and the expenses unpaid (as defined in paragraphs (5)(B) and (6) of section 832(b) of the Internal Revenue Code of 1986) at the end of the preceding taxable year, and

(2) the unpaid losses as defined in sections 807(c)(2) and 805(a)(1) of such Code at the end of the preceding taxable year,

shall be determined as if the amendments made by this section had applied to such unpaid losses and expenses unpaid in the preceding taxable year and by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018, and any adjustment shall be taken into account ratably in such first taxable year and the 7 succeeding taxable years. For subsequent taxable years, such amendments shall be applied with respect to such unpaid losses and expenses unpaid by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018.

SEC. 3708. REPEAL OF SPECIAL ESTIMATED TAX PAYMENTS.

(a) IN GENERAL.—Part III of subchapter L of chapter 1 is amended by striking section 847 (and by striking the item relating to such section in the table of sections for such part).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle I—Compensation

SEC. 3801. MODIFICATION OF LIMITATION ON EXCESSIVE EMPLOYEE REMUNERATION.

(a) REPEAL OF PERFORMANCE-BASED COMPENSATION AND COMMISSION EXCEPTIONS FOR LIMITATION ON EXCESSIVE EMPLOYEE REMUNERATION.—

(1) IN GENERAL.—Section 162(m)(4) is amended by striking subparagraphs (B) and (C) and by redesignating subparagraphs (D), (E), (F), and (G) as subparagraphs (B), (C), (D), and (E), respectively.

(2) CONFORMING AMENDMENTS.—

(A) Paragraphs (5)(E) and (6)(D) of section 162(m) are each amended by striking "subparagraphs (B), (C), and (D)" and inserting "subparagraph (B)".

(B) Paragraphs (5)(G) and (6)(G) of section 162(m) are each amended by striking "(F) and (G)" and inserting "(D) and (E)".

(b) EXPANSION OF APPLICABLE EMPLOYER.—Section 162(m)(2) is amended to read as follows:

"(2) PUBLICLY HELD CORPORATION.—For purposes of this subsection, the term 'publicly held corporation' means any corporation which is an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c))—

"(A) the securities of which are required to be registered under section 12 of such Act (15 U.S.C. 78l), or

"(B) that is required to file reports under section 15(d) of such Act (15 U.S.C. 78o(d)).".

(c) MODIFICATION OF DEFINITION OF COVERED EMPLOYEES.—Section 162(m)(3) is amended—

(1) in subparagraph (A), by striking "as of the close of the taxable year, such employee is the chief executive officer of the taxpayer or is" and inserting "such employee is the principal executive officer or principal financial officer of the taxpayer at any time during the taxable year, or was",

(2) in subparagraph (B)—

(A) by striking "4" and inserting "3", and

(B) by striking "(other than the chief executive officer)" and inserting "(other than the principal executive officer or principal financial officer)", and

(3) by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end the following:

"(C) was a covered employee of the taxpayer (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

Such term shall include any employee who would be described in subparagraph (B) if the reporting described in such subparagraph were required as so described.".

(d) SPECIAL RULE FOR REMUNERATION PAID TO BENEFICIARIES, ETC.—Section 162(m)(4), as amended by subsection (a), is amended by adding at the end the following new subparagraph:

"(F) SPECIAL RULE FOR REMUNERATION PAID TO BENEFICIARIES, ETC.—Remuneration shall not fail to be applicable employee remuneration merely because it is includible in the income of, or paid to, a person other than the covered employee, including after the death of the covered employee.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3802. EXCISE TAX ON EXCESS TAX-EXEMPT ORGANIZATION EXECUTIVE COMPENSATION.

(a) IN GENERAL.—Subchapter D of chapter 42 is amended by adding at the end the following new section:

"SEC. 4960. TAX ON EXCESS TAX-EXEMPT ORGANIZATION EXECUTIVE COMPENSATION.

"(a) TAX IMPOSED.—There is hereby imposed a tax equal to 20 percent of the sum of—

"(1) so much of the remuneration paid (other than any excess parachute payment) by an applicable tax-exempt organization for the taxable year with respect to employment of any covered employee in excess of $1,000,000, plus

"(2) any excess parachute payment paid by such an organization to any covered employee.

"(b) LIABILITY FOR TAX.—The employer shall be liable for the tax imposed under subsection (a).

"(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) APPLICABLE TAX-EXEMPT ORGANIZATION.—The term 'applicable tax-exempt organization' means any organization that for the taxable year—

"(A) is exempt from taxation under section 501(a),

"(B) is a farmers' cooperative organization described in section 521(b)(1),

"(C) has income excluded from taxation under section 115(1), or

"(D) is a political organization described in section 527(e)(1).

"(2) COVERED EMPLOYEE.—For purposes of this section, the term 'covered employee' means any employee (including any former employee) of an applicable tax-exempt organization if the employee—

"(A) is one of the 5 highest compensated employees of the organization for the taxable year, or

"(B) was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016.

"(3) REMUNERATION.—For purposes of this section, the term 'remuneration' means wages (as defined in section 3401(a)), except that such term shall not include any designated Roth contribution (as defined in section 402A(c)).

"(4) REMUNERATION FROM RELATED ORGANIZATIONS.—

"(A) IN GENERAL.—Remuneration of a covered employee paid by an applicable tax-exempt organization shall include any remuneration paid with respect to employment of such employee by any related person or governmental entity.

"(B) RELATED ORGANIZATIONS.—A person or governmental entity shall be treated as related to an applicable tax-exempt organization if such person or governmental entity—

"(i) controls, or is controlled by, the organization,

"(ii) is controlled by one or more persons that control the organization,

"(iii) is a supported organization (as defined in section 509(f)(2)) during the taxable year with respect to the organization,

"(iv) is a supporting organization described in section 509(a)(3) during the taxable year with respect to the organization, or

"(v) in the case of an organization that is a voluntary employees' beneficiary association described in section 501(a)(9), establishes, maintains, or makes contributions to such voluntary employees' beneficiary association.

"(C) LIABILITY FOR TAX.—In any case in which remuneration from more than one employer is taken into account under this paragraph in determining the tax imposed by subsection (a), each such employer shall be liable for such tax in an amount which bears the same ratio to the total tax determined under subsection (a) with respect to such remuneration as—

"(i) the amount of remuneration paid by such employer with respect to such employee, bears to

"(ii) the amount of remuneration paid by all such employers to such employee.

"(5) EXCESS PARACHUTE PAYMENT.—For purposes determining the tax imposed by subsection (a)(2)—

"(A) IN GENERAL.—The term 'excess parachute payment' means an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment.

"(B) PARACHUTE PAYMENT.—The term 'parachute payment' means any payment in the nature of compensation to (or for the benefit of) a covered employee if—

"(i) such payment is contingent on such employee's separation from employment with the employer, and

"(ii) the aggregate present value of the payments in the nature of compensation to (or for the benefit of) such individual which are contingent on such separation equals or exceeds an amount equal to 3 times the base amount.

Such term does not include any payment described in section 280G(b)(6) (relating to exemption for payments under qualified plans) or any payment made under or to an annuity contract described in section 403(b) or a plan described in section 457(b).

"(C) BASE AMOUNT.—Rules similar to the rules of 280G(b)(3) shall apply for purposes of determining the base amount.

"(D) PROPERTY TRANSFERS; PRESENT VALUE.—Rules similar to the rules of paragraphs (3) and (4) of section 280G(d) shall apply.

"(6) COORDINATION WITH DEDUCTION LIMITATION.—Remuneration the deduction for which is not allowed by reason of section 162(m) shall not be taken into account for purposes of this section.

"(d) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to prevent avoidance of the purposes of this section through the performance of services other than as an employee.".

(b) CLERICAL AMENDMENT.—The table of sections for subchapter D of chapter 42 is amended by adding at the end the following new item:

"Sec. 4960. Tax on excess exempt organization executive compensation.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 3803. TREATMENT OF QUALIFIED EQUITY GRANTS.

(a) IN GENERAL.—

(1) ELECTION TO DEFER INCOME.—Section 83 is amended by adding at the end the following new subsection:

"(i) QUALIFIED EQUITY GRANTS.—

"(1) IN GENERAL.—For purposes of this subtitle, if qualified stock is transferred to a qualified employee who makes an election with respect to such stock under this subsection—

"(A) except as provided in subparagraph (B), no amount shall be included in income under subsection (a) for the first taxable year in which the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable, and

"(B) an amount equal to the amount which would be included in income of the employee under subsection (a) (determined without regard to this subsection) shall be included in income for the taxable year of the employee which includes the earliest of—

"(i) the first date such qualified stock becomes transferable (including transferable to the employer),

"(ii) the date the employee first becomes an excluded employee,

"(iii) the first date on which any stock of the corporation which issued the qualified stock becomes readily tradable on an established securities market (as determined by the Secretary, but not including any market unless such market is recognized as an established securities market by the Secretary for purposes of a provision of this title other than this subsection),

"(iv) the date that is 5 years after the first date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, or

"(v) the date on which the employee revokes (at such time and in such manner as the Secretary may provide) the election under this subsection with respect to such stock.

"(2) QUALIFIED STOCK.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'qualified stock' means, with respect to any qualified employee, any stock in a corporation which is the employer of such employee, if—

"(i) such stock is received—

"(I) in connection with the exercise of an option, or

"(II) in settlement of a restricted stock unit, and

"(ii) such option or restricted stock unit was provided by the corporation—

"(I) in connection with the performance of services as an employee, and

"(II) during a calendar year in which such corporation was an eligible corporation.

"(B) LIMITATION.—The term 'qualified stock' shall not include any stock if the employee may sell such stock to, or otherwise receive cash in lieu of stock from, the corporation at the time that the rights of the employee in such stock first become transferable or not subject to a substantial risk of forfeiture.

"(C) ELIGIBLE CORPORATION.—For purposes of subparagraph (A)(ii)(II)—

"(i) IN GENERAL.—The term 'eligible corporation' means, with respect to any calendar year, any corporation if—

"(I) no stock of such corporation (or any predecessor of such corporation) is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) during any preceding calendar year, and

"(II) such corporation has a written plan under which, in such calendar year, not less than 80 percent of all employees who provide services to such corporation in the United States (or any possession of the United States) are granted stock options, or restricted stock units, with the same rights and privileges to receive qualified stock.

"(ii) SAME RIGHTS AND PRIVILEGES.—For purposes of clause (i)(II)—

"(I) except as provided in subclauses (II) and (III), the determination of rights and privileges with respect to stock shall be determined in a similar manner as provided under section 423(b)(5),

"(II) employees shall not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, so long as the number of shares available to each employee is more than a de minimis amount, and

"(III) rights and privileges with respect to the exercise of an option shall not be treated as the same as rights and privileges with respect to the settlement of a restricted stock unit.

"(iii) EMPLOYEE.—For purposes of clause (i)(II), the term 'employee' shall not include any employee described in section 4980E(d)(4) or any excluded employee.

"(iv) SPECIAL RULE FOR CALENDAR YEARS BEFORE 2018.—In the case of any calendar year beginning before January 1, 2018, clause (i)(II) shall be applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

"(3) QUALIFIED EMPLOYEE; EXCLUDED EMPLOYEE.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified employee' means any individual who—

"(i) is not an excluded employee, and

"(ii) agrees in the election made under this subsection to meet such requirements as determined by the Secretary to be necessary to ensure that the withholding requirements of the corporation under chapter 24 with respect to the qualified stock are met.

"(B) EXCLUDED EMPLOYEE.—The term 'excluded employee' means, with respect to any corporation, any individual—

"(i) who was a 1-percent owner (within the meaning of section 416(i)(1)(B)(ii)) at any time during the 10 preceding calendar years,

"(ii) who is or has been at any prior time—

"(I) the chief executive officer of such corporation or an individual acting in such a capacity, or

"(II) the chief financial officer of such corporation or an individual acting in such a capacity,

"(iii) who bears a relationship described in section 318(a)(1) to any individual described in subclause (I) or (II) of clause (ii), or

"(iv) who has been for any of the 10 preceding taxable years one of the 4 highest compensated officers of such corporation determined with respect to each such taxable year on the basis of the shareholder disclosure rules for compensation under the Securities Exchange Act of 1934 (as if such rules applied to such corporation).

"(4) ELECTION.—

"(A) TIME FOR MAKING ELECTION.—An election with respect to qualified stock shall be made under this subsection no later than 30 days after the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under subsection (b).

"(B) LIMITATIONS.—No election may be made under this section with respect to any qualified stock if—

"(i) the qualified employee has made an election under subsection (b) with respect to such qualified stock,

"(ii) any stock of the corporation which issued the qualified stock is readily tradable on an established securities market (as determined under paragraph (1)(B)(iii)) at any time before the election is made, or

"(iii) such corporation purchased any of its outstanding stock in the calendar year preceding the calendar year which includes the first time the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, unless—

"(I) not less than 25 percent of the total dollar amount of the stock so purchased is deferral stock, and

"(II) the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.

"(C) DEFINITIONS AND SPECIAL RULES RELATED TO LIMITATION ON STOCK REDEMPTIONS.—

"(i) DEFERRAL STOCK.—For purposes of this paragraph, the term 'deferral stock' means stock with respect to which an election is in effect under this subsection.

"(ii) DEFERRAL STOCK WITH RESPECT TO ANY INDIVIDUAL NOT TAKEN INTO ACCOUNT IF INDIVIDUAL HOLDS DEFERRAL STOCK WITH LONGER DEFERRAL PERIOD.—Stock purchased by a corporation from any individual shall not be treated as deferral stock for purposes of clause (iii) if such individual (immediately after such purchase) holds any deferral stock with respect to which an election has been in effect under this subsection for a longer period than the election with respect to the stock so purchased.

"(iii) PURCHASE OF ALL OUTSTANDING DEFERRAL STOCK.—The requirements of subclauses (I) and (II) of subparagraph (B)(iii) shall be treated as met if the stock so purchased includes all of the corporation's outstanding deferral stock.

"(iv) REPORTING.—Any corporation which has outstanding deferral stock as of the beginning of any calendar year and which purchases any of its outstanding stock during such calendar year shall include on its return of tax for the taxable year in which, or with which, such calendar year ends the total dollar amount of its outstanding stock so purchased during such calendar year and such other information as the Secretary may require for purposes of administering this paragraph.

"(5) CONTROLLED GROUPS.—For purposes of this subsection, all corporations which are members of the same controlled group of corporations (as defined in section 1563(a)) shall be treated as one corporation.

"(6) NOTICE REQUIREMENT.—Any corporation that transfers qualified stock to a qualified employee shall, at the time that (or a reasonable period before) an amount attributable to such stock would (but for this subsection) first be includible in the gross income of such employee—

"(A) certify to such employee that such stock is qualified stock, and

"(B) notify such employee—

"(i) that the employee may elect to defer income on such stock under this subsection, and

"(ii) that, if the employee makes such an election—

"(I) the amount of income recognized at the end of the deferral period will be based on the value of the stock at the time at which the rights of the employee in such stock first become transferable or not subject to substantial risk of forfeiture, notwithstanding whether the value of the stock has declined during the deferral period,

"(II) the amount of such income recognized at the end of the deferral period will be subject to withholding under section 3401(i) at the rate determined under section 3402(t), and

"(III) the responsibilities of the employee (as determined by the Secretary under paragraph (3)(A)(ii)) with respect to such withholding.

"(7) RESTRICTED STOCK UNITS.—This section (other than this subsection), including any election under subsection (b), shall not apply to restricted stock units.".

(2) DEDUCTION BY EMPLOYER.—Subsection (h) of section 83 is amended by striking "or (d)(2)" and inserting "(d)(2), or (i)".

(b) WITHHOLDING.—

(1) TIME OF WITHHOLDING.—Section 3401 is amended by adding at the end the following new subsection:

"(i) QUALIFIED STOCK FOR WHICH AN ELECTION IS IN EFFECT UNDER SECTION 83(i).—For purposes of subsection (a), qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i) shall be treated as wages—

"(1) received on the earliest date described in section 83(i)(1)(B), and

"(2) in an amount equal to the amount included in income under section 83 for the taxable year which includes such date.".

(2) AMOUNT OF WITHHOLDING.—Section 3402 is amended by adding at the end the following new subsection:

"(t) RATE OF WITHHOLDING FOR CERTAIN STOCK.—In the case of any qualified stock (as defined in section 83(i)) with respect to which an election is made under section 83(i)—

"(1) the rate of tax under subsection (a) shall not be less than the maximum rate of tax in effect under section 1, and

"(2) such stock shall be treated for purposes of section 3501(b) in the same manner as a non-cash fringe benefit.".

(c) COORDINATION WITH OTHER DEFERRED COMPENSATION RULES.—

(1) ELECTION TO APPLY DEFERRAL TO STATUTORY OPTIONS.—

(A) INCENTIVE STOCK OPTIONS.—Section 422(b) is amended by adding at the end the following: "Such term shall not include any option if an election is made under section 83(i) with respect to the stock received in connection with the exercise of such option.".

(B) EMPLOYEE STOCK PURCHASE PLANS.—Section 423(a) is amended by adding at the end the following flush sentence:

"The preceding sentence shall not apply to any share of stock with respect to which an election is made under section 83(i).".

(2) EXCLUSION FROM DEFINITION OF NONQUALIFIED DEFERRED COMPENSATION PLAN.—Subsection (d) of section 409A is amended by adding at the end the following new paragraph:

"(7) TREATMENT OF QUALIFIED STOCK.—An arrangement under which an employee may receive qualified stock (as defined in section 83(i)(2)) shall not be treated as a nonqualified deferred compensation plan solely because of an employee's election, or ability to make an election, to defer recognition of income under section 83(i).".

(d) INFORMATION REPORTING.—Section 6051(a) is amended by striking "and" at the end of paragraph (13), by striking the period at the end of paragraph (14) and inserting a comma, and by inserting after paragraph (14) the following new paragraphs:

"(15) the amount excludable from gross income under subparagraph (A) of section 83(i)(1),

"(16) the amount includible in gross income under subparagraph (B) of section 83(i)(1) with respect to an event described in such subparagraph which occurs in such calendar year, and

"(17) the aggregate amount of income which is being deferred pursuant to elections under section 83(i), determined as of the close of the calendar year.".

(e) PENALTY FOR FAILURE OF EMPLOYER TO PROVIDE NOTICE OF TAX CONSEQUENCES.—Section 6652 is amended by adding at the end the following new subsection:

"(o) FAILURE TO PROVIDE NOTICE UNDER SECTION 83(i).—In the case of each failure to provide a notice as required by section 83(i)(6), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such notice, an amount equal to $100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $50,000.".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to stock attributable to options exercised, or restricted stock units settled, after December 31, 2017.

(2) REQUIREMENT TO PROVIDE NOTICE.—The amendments made by subsection (e) shall apply to failures after December 31, 2017.

(g) TRANSITION RULE.—Until such time as the Secretary (or the Secretary's delegate) issue regulations or other guidance for purposes of implementing the requirements of paragraph (2)(C)(i)(II) of section 83(i) of the Internal Revenue Code of 1986 (as added by this section), or the requirements of paragraph (6) of such section, a corporation shall be treated as being in compliance with such requirements (respectively) if such corporation complies with a reasonable good faith interpretation of such requirements.

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.

(a) IN GENERAL.—Part VIII of subchapter B of chapter 1 is amended by inserting after section 245 the following new section:

"SEC. 245A. DEDUCTION FOR FOREIGN-SOURCE PORTION OF DIVIDENDS RECEIVED BY DOMESTIC CORPORATIONS FROM SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

"(a) IN GENERAL.—In the case of any dividend received from a specified 10-percent owned foreign corporation by a domestic corporation which is a United States shareholder with respect to such foreign corporation, there shall be allowed as a deduction an amount equal to the foreign-source portion of such dividend.

"(b) SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATION.—For purposes of this section, the term 'specified 10-percent owned foreign corporation' means any foreign corporation with respect to which any domestic corporation is a United States shareholder. Such term shall not include any passive foreign investment company (within the meaning of subpart D of part VI of subchapter P) that is not a controlled foreign corporation.

"(c) FOREIGN-SOURCE PORTION.—For purposes of this section—

"(1) IN GENERAL.—The foreign-source portion of any dividend is an amount which bears the same ratio to such dividend as—

"(A) the post-1986 undistributed foreign earnings of the specified 10-percent owned foreign corporation, bears to

"(B) the total post-1986 undistributed earnings of such foreign corporation.

"(2) POST-1986 UNDISTRIBUTED EARNINGS.—The term 'post-1986 undistributed earnings' means the amount of the earnings and profits of the specified 10-percent owned foreign corporation (computed in accordance with sections 964(a) and 986) accumulated in taxable years beginning after December 31, 1986—

"(A) as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed, and

"(B) without diminution by reason of dividends distributed during such taxable year.

"(3) POST-1986 UNDISTRIBUTED FOREIGN EARNINGS.—The term 'post-1986 undistributed foreign earnings' means the portion of the post-1986 undistributed earnings which is attributable to neither—

"(A) income described in subparagraph (A) of section 245(a)(5), nor

"(B) dividends described in subparagraph (B) of such section (determined without regard to section 245(a)(12)).

"(4) TREATMENT OF DISTRIBUTIONS FROM EARNINGS BEFORE 1987.—

"(A) IN GENERAL.—In the case of any dividend paid out of earnings and profits of the specified 10-percent owned foreign corporation (computed in accordance with sections 964(a) and 986) accumulated in taxable years beginning before January 1, 1987—

"(i) paragraphs (1), (2), and (3) shall be applied without regard to the phrase 'post-1986' each place it appears, and

"(ii) paragraph (2) shall be applied by substituting 'after the date specified in section 316(a)(1)' for 'in taxable years beginning after December 31, 1986'.

"(B) DIVIDENDS PAID FIRST OUT OF POST-1986 EARNINGS.—Dividends shall be treated as paid out of post-1986 undistributed earnings to the extent thereof.

"(5) TREATMENT OF CERTAIN DIVIDENDS IN EXCESS OF UNDISTRIBUTED EARNINGS.—In the case of any dividend from the specified 10-percent owned foreign corporation which is in excess of undistributed earnings (as determined under paragraph (2) after taking into account the modifications described in clauses (i) and (ii) of paragraph (4)(A)), the foreign-source portion of such dividend is an amount which bears the same ratio to such dividend as—

"(A) the portion of the earnings and profits described in subparagraph (B) which is attributable to neither income described in paragraph (3)(A) nor dividends described in paragraph (3)(B), bears to

"(B) the earnings and profits of such corporation for the taxable year in which such distribution is made (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year).

"(d) DISALLOWANCE OF FOREIGN TAX CREDIT, ETC.—

"(1) IN GENERAL.—No credit shall be allowed under section 901 for any taxes paid or accrued (or treated as paid or accrued) with respect to any dividend for which a deduction is allowed under this section.

"(2) DENIAL OF DEDUCTION.—No deduction shall be allowed under this chapter for any tax for which credit is not allowable under section 901 by reason of paragraph (1) (determined by treating the taxpayer as having elected the benefits of subpart A of part III of subchapter N).

"(e) REGULATIONS.—The Secretary may prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.".

(b) APPLICATION OF HOLDING PERIOD REQUIREMENT.—Section 246(c) is amended—

(1) by striking "or 245" in paragraph (1) and inserting "245, or 245A", and

(2) by adding at the end the following new paragraph:

"(5) SPECIAL RULES FOR FOREIGN SOURCE PORTION OF DIVIDENDS RECEIVED FROM SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.—

"(A) 6-MONTH HOLDING PERIOD REQUIREMENT.—For purposes of section 245A—

"(i) paragraph (1)(A) shall be applied—

"(I) by substituting '180 days' for '45 days'each place it appears, and

"(II) by substituting '361-day period' for '91-day period', and

"(ii) paragraph (2) shall not apply.

"(B) STATUS MUST BE MAINTAINED DURING HOLDING PERIOD.—For purposes of applying paragraph (1) with respect to section 245A, the taxpayer shall be treated as holding the stock referred to in paragraph (1) for any period only if—

"(i) the specified 10-percent owned foreign corporation referred to in section 245A(a) is a specified 10-percent owned foreign corporation for such period, and "(ii) the taxpayer is a United States shareholder with respect to such specified 10-percent owned foreign corporation for such period.".

(c) APPLICATION OF RULES GENERALLY APPLICABLE TO DEDUCTIONS FOR DIVIDENDS RECEIVED.—

(1) TREATMENT OF DIVIDENDS FROM CERTAIN CORPORATIONS.—Section 246(a)(1) is amended by striking "and 245" and inserting "245, and 245A".

(2) COORDINATION WITH SECTION 1059.—Section 1059(b)(2)(B) is amended by striking "or 245" and inserting "245, or 245A".

(d) COORDINATION WITH FOREIGN TAX CREDIT LIMITATION.—Section 904(b) is amended by adding at the end the following new paragraph:

"(5) TREATMENT OF DIVIDENDS FOR WHICH DEDUCTION IS ALLOWED UNDER SECTION 245A.—For purposes of subsection (a), in the case of a United States shareholder with respect to a specified 10-percent owned foreign corporation, such shareholder's taxable income from sources without the United States (and entire taxable income) shall be determined without regard to—

"(A) the foreign-source portion of any dividend received from such foreign corporation, and

"(B) any deductions properly allocable or apportioned to—

"(i) income (other than subpart F income (as defined in section 952) and foreign high return amounts (as defined in section 951A(b)) with respect to stock of such specified 10-percent owned foreign corporation, or

"(ii) such stock (to the extent income with respect to such stock is other than subpart F income (as so defined) or foreign high return amounts (as so defined)).

Any term which is used in section 245A and in this paragraph shall have the same meaning for purposes of this paragraph as when used in such section.".

(e) CONFORMING AMENDMENTS.—

(1) Section 245(a)(4) is amended by striking "section 902(c)(1)" and inserting "section 245A(c)(2) applied by substituting 'qualified 10-percent owned foreign corporation' for 'specified 10-percent owned foreign corporation' each place it appears".

(2) Section 951(b) is amended by striking "subpart" and inserting "title".

(3) Section 957(a) is amended by striking "subpart" in the matter preceding paragraph (1) and inserting "title".

(4) The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting after section 245 the following new item:

"Sec. 245A. Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after (and, in the case of the amendments made by subsection (d), deductions with respect to taxable years ending after) December 31, 2017.

SEC. 4002. APPLICATION OF PARTICIPATION EXEMPTION TO INVESTMENTS IN UNITED STATES PROPERTY.

(a) IN GENERAL.—Section 956(a) is amended in the matter preceding paragraph (1) by inserting "(other than a corporation)" after "United States shareholder".

(b) REGULATORY AUTHORITY TO PREVENT ABUSE.—Section 956(e) is amended by striking "including regulations to prevent" and inserting "including regulations—

"(1) to address United States shareholders that are partnerships with corporate partners, and

"(2) to prevent".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017.

SEC. 4003. LIMITATION ON LOSSES WITH RESPECT TO SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

(a) BASIS IN SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATION REDUCED BY NONTAXED PORTION OF DIVIDEND FOR PURPOSES OF DETERMINING LOSS.—

(1) IN GENERAL.—Section 961 is amended by adding at the end the following new subsection:

"(d) BASIS IN SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATION REDUCED BY NONTAXED PORTION OF DIVIDEND FOR PURPOSES OF DETERMINING LOSS.—If a domestic corporation received a dividend from a specified 10-percent owned foreign corporation (as defined in section 245A) in any taxable year, solely for purposes of determining loss on any disposition of stock of such foreign corporation in such taxable year or any subsequent taxable year, the basis of such domestic corporation in such stock shall be reduced (but not below zero) by the amount of any deduction allowable to such domestic corporation under section 245A with respect to such stock except to the extent such basis was reduced under section 1059 by reason of a dividend for which such a deduction was allowable.".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to distributions made after December 31, 2017.

(b) TREATMENT OF FOREIGN BRANCH LOSSES TRANSFERRED TO SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.—

(1) IN GENERAL.—Part II of subchapter B of chapter 1 is amended by adding at the end the following new section:

"SEC. 91. CERTAIN FOREIGN BRANCH LOSSES TRANSFERRED TO SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

"(a) IN GENERAL.—If a domestic corporation transfers substantially all of the assets of a foreign branch (within the meaning of section 367(a)(3)(C)) to a specified 10-percent owned foreign corporation (as defined in section 245A) with respect to which it is a United States shareholder after such transfer, such domestic corporation shall include in gross income for the taxable year which includes such transfer an amount equal to the transferred loss amount with respect to such transfer.

"(b) TRANSFERRED LOSS AMOUNT.—For purposes of this section, the term 'transferred loss amount' means, with respect to any transfer of substantially all of the assets of a foreign branch, the excess (if any) of—

"(1) the sum of losses—

"(A) which were incurred by the foreign branch after December 31, 2017, and before the transfer, and

"(B) with respect to which a deduction was allowed to the taxpayer, over

"(2) the sum of—

"(A) any taxable income of such branch for a taxable year after the taxable year in which the loss was incurred and through the close of the taxable year of the transfer, and

"(B) any amount which is recognized under section 904(f)(3) on account of the transfer.

"(c) REDUCTION FOR RECOGNIZED GAINS.—

"(1) IN GENERAL.—In the case of a transfer not described in section 367(a)(3)(C), the transferred loss amount shall be reduced (but not below zero) by the amount of gain recognized by the taxpayer on account of the transfer (other than amounts taken into account under subsection (c)(2)(B)).

"(2) COORDINATION WITH RECOGNITION UNDER SECTION 367.—In the case of a transfer described in section 367(a)(3)(C), the transferred loss amount shall not exceed the excess (if any) of—

"(A) the excess of the amount described in section 367(a)(3)(C)(i) over the amount described in section 367(a)(3)(C)(ii) with respect to such transfer, over

"(B) the amount of gain recognized under section 367(a)(3)(C) with respect to such transfer.

"(d) SOURCE OF INCOME.—Amounts included in gross income under this section shall be treated as derived from sources within the United States.

"(e) BASIS ADJUSTMENTS.—Consistent with such regulations or other guidance as the Secretary may prescribe, proper adjustments shall be made in the adjusted basis of the taxpayer's stock in the specified 10-percent owned foreign corporation to which the transfer is made, and in the transferee's adjusted basis in the property transferred, to reflect amounts included in gross income under this section.".

(2) AMOUNTS RECOGNIZED UNDER SECTION 367 ON TRANSFER OF FOREIGN BRANCH WITH PREVIOUSLY DEDUCTED LOSSES TREATED AS UNITED STATES SOURCE.—Section 367(a)(3)(C) is amended by striking "outside" in the last sentence and inserting "within".

(3) CLERICAL AMENDMENT.—The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end the following new item:

"Sec. 91. Certain foreign branch losses transferred to specified 10-percent owned foreign corporations.".

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to transfers after December 31, 2017.

SEC. 4004. TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO PARTICIPATION EXEMPTION SYSTEM OF TAXATION.

(a) IN GENERAL.—Section 965 is amended to read as follows:

"SEC. 965. TREATMENT OF DEFERRED FOREIGN INCOME UPON TRANSITION TO PARTICIPATION EXEMPTION SYSTEM OF TAXATION.

"(a) TREATMENT OF DEFERRED FOREIGN INCOME AS SUBPART F INCOME.—In the case of the last taxable year of a deferred foreign income corporation which begins before January 1, 2018, the subpart F income of such foreign corporation (as otherwise determined for such taxable year under section 952) shall be increased by the greater of—

"(1) the accumulated post-1986 deferred foreign income of such corporation determined as of November 2, 2017, or

"(2) the accumulated post-1986 deferred foreign income of such corporation determined as of December 31, 2017.

"(b) REDUCTION IN AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS OF SPECIFIED FOREIGN CORPORATIONS WITH DEFICITS IN EARNINGS AND PROFITS.—

"(1) IN GENERAL.—In the case of a taxpayer which is a United States shareholder with respect to at least one deferred foreign income corporation and at least one E&P deficit foreign corporation, the amount which would (but for this subsection) be taken into account under section 951(a)(1) by reason of subsection (a) as such United States shareholder's pro rata share of the subpart F income of each deferred foreign income corporation shall be reduced (but not below zero) by the amount of such United States shareholder's aggregate foreign E&P deficit which is allocated under paragraph (2) to such deferred foreign income corporation.

"(2) ALLOCATION OF AGGREGATE FOREIGN E&P DEFICIT.—The aggregate foreign E&P deficit of any United States shareholder shall be allocated among the deferred foreign income corporations of such United States shareholder in an amount which bears the same proportion to such aggregate as—

"(A) such United States shareholder's pro rata share of the accumulated post-1986 deferred foreign income of each such deferred foreign income corporation, bears to

"(B) the aggregate of such United States shareholder's pro rata share of the accumulated post-1986 deferred foreign income of all deferred foreign income corporations of such United States shareholder.

"(3) DEFINITIONS RELATED TO E&P DEFICITS.—For purposes of this subsection—

"(A) AGGREGATE FOREIGN E&P DEFICIT.—The term 'aggregate foreign E&P deficit' means, with respect to any United States shareholder, the aggregate of such shareholder's pro rata shares of the specified E&P deficits of the E&P deficit foreign corporations of such shareholder.

"(B) E&P DEFICIT FOREIGN CORPORATION.—The term 'E&P deficit foreign corporation' means, with respect to any taxpayer, any specified foreign corporation with respect to which such taxpayer is a United States shareholder, if—

"(i) such specified foreign corporation has a deficit in post-1986 earnings and profits, and

"(ii) as of November 2, 2017—

"(I) such corporation was a specified foreign corporation, and

"(II) such taxpayer was a United States shareholder of such corporation.

"(C) SPECIFIED E&P DEFICIT.—The term 'specified E&P deficit' means, with respect to any E&P deficit foreign corporation, the amount of the deficit referred to in subparagraph (B).

"(4) NETTING AMONG UNITED STATES SHAREHOLDERS IN SAME AFFILIATED GROUP.—

"(A) IN GENERAL.—In the case of any affiliated group which includes at least one E&P net surplus shareholder and one E&P net deficit shareholder, the amount which would (but for this paragraph) be taken into account under section 951(a)(1) by reason of subsection (a) by each such E&P net surplus shareholder shall be reduced (but not below zero) by such shareholder's applicable share of the affiliated group's aggregate unused E&P deficit.

"(B) E&P NET SURPLUS SHAREHOLDER.—For purposes of this paragraph, the term 'E&P net surplus shareholder' means any United States shareholder which would (determined without regard to this paragraph) take into account an amount greater than zero under section 951(a)(1) by reason of subsection (a).

"(C) E&P NET DEFICIT SHAREHOLDER.—For purposes of this paragraph, the term 'E&P net deficit shareholder' means any United States shareholder if—

"(i) the aggregate foreign E&P deficit with respect to such shareholder (as defined in paragraph (3)(A)), exceeds

"(ii) the amount which would (but for this subsection) be taken into account by such shareholder under section 951(a)(1) by reason of subsection (a).

"(D) AGGREGATE UNUSED E&P DEFICIT.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'aggregate unused E&P deficit' means, with respect to any affiliated group, the lesser of—

"(I) the sum of the excesses described in subparagraph (C), determined with respect to each E&P net deficit shareholder in such group, or

"(II) the amount determined under subparagraph (E)(ii).

"(ii) REDUCTION WITH RESPECT TO E&P NET DEFICIT SHAREHOLDERS WHICH ARE NOT WHOLLY OWNED BY THE AFFILIATED GROUP.—If the group ownership percentage of any E&P net deficit shareholder is less than 100 percent, the amount of the excess described in subparagraph (C) which is taken into account under clause (i)(I) with respect to such E&P net deficit shareholder shall be such group ownership percentage of such amount.

"(E) APPLICABLE SHARE.—For purposes of this paragraph, the term 'applicable share' means, with respect to any E&P net surplus shareholder in any affiliated group, the amount which bears the same proportion to such group's aggregate unused E&P deficit as—

"(i) the product of—

"(I) such shareholder's group ownership percentage, multiplied by

"(II) the amount which would (but for this paragraph) be taken into account under section 951(a)(1) by reason of subsection (a) by such shareholder, bears to

"(ii) the aggregate amount determined under clause (i) with respect to all E&P net surplus shareholders in such group.

"(F) GROUP OWNERSHIP PERCENTAGE.—For purposes of this paragraph, the term 'group ownership percentage' means, with respect to any United States shareholder in any affiliated group, the percentage of the value of the stock of such United States shareholder which is held by other includible corporations in such affiliated group. Notwithstanding the preceding sentence, the group ownership percentage of the common parent of the affiliated group is 100 percent. Any term used in this subparagraph which is also used in section 1504 shall have the same meaning as when used in such section.

"(c) APPLICATION OF PARTICIPATION EXEMPTION TO INCLUDED INCOME.—

"(1) IN GENERAL.—In the case of a United States shareholder of a deferred foreign income corporation, there shall be allowed as a deduction for the taxable year in which an amount is included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section an amount equal to the sum of—

"(A) the United States shareholder's 7 percent rate equivalent percentage of the excess (if any) of—

"(i) the amount so included as gross income, over

"(ii) the amount of such United States shareholder's aggregate foreign cash position, plus

"(B) the United States shareholder's 14 percent rate equivalent percentage of so much of the amount described in subparagraph (A)(ii) as does not exceed the amount described in subparagraph (A)(i).

"(2) 7 AND 14 PERCENT RATE EQUIVALENT PERCENTAGES.—For purposes of this subsection—

"(A) 7 PERCENT RATE EQUIVALENT PERCENTAGE.—The term '7 percent rate equivalent percentage' means, with respect to any United States shareholder for any taxable year, the percentage which would result in the amount to which such percentage applies being subject to a 7 percent rate of tax determined by only taking into account a deduction equal to such percentage of such amount and the highest rate of tax specified in section 11 for such taxable year. In the case of any taxable year of a United States shareholder to which section 15 applies, the highest rate of tax under section 11 before the effective date of the change in rates and the highest rate of tax under section 11 after the effective date of such change shall each be taken into account under the preceding sentence in the same proportions as the portion of such taxable year which is before and after such effective date, respectively.

"(B) 14 PERCENT RATE EQUIVALENT PERCENTAGE.—The term '14 percent rate equivalent percentage' means, with respect to any United States shareholder for any taxable year, the percentage determined under subparagraph (A) applied by substituting '14 percent rate of tax' for '7 percent rate of tax'.

"(3) AGGREGATE FOREIGN CASH POSITION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'aggregate foreign cash position' means, with respect to any United States shareholder, one-third of the sum of—

"(i) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of November 2, 2017,

"(ii) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation which ends before November 2, 2017, and

"(iii) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in clause (ii).

In the case of any foreign corporation which did not exist as of the determination date described in clause (ii) or (iii), this subparagraph shall be applied separately to such foreign corporation by not taking into account such clause and by substituting 'one-half (100 percent in the case that both clauses (ii) and (iii) are disregarded)' for 'one-third'.

"(B) CASH POSITION.—For purposes of this paragraph, the cash position of any specified foreign corporation is the sum of—

"(i) cash held by such foreign corporation,

"(ii) the net accounts receivable of such foreign corporation, plus

"(iii) the fair market value of the following assets held by such corporation:

"(I) Actively traded personal property for which there is an established financial market.

"(II) Commercial paper, certificates of deposit, the securities of the Federal government and of any State or foreign government.

"(III) Any foreign currency.

"(IV) Any obligation with a term of less than one year.

"(V) Any asset which the Secretary identifies as being economically equivalent to any asset described in this subparagraph.

"(C) NET ACCOUNTS RECEIVABLE.—For purposes of this paragraph, the term 'net accounts receivable' means, with respect to any specified foreign corporation, the excess (if any) of—

"(i) such corporation's accounts receivable, over

"(ii) such corporation's accounts payable (determined consistent with the rules of section 461).

"(D) PREVENTION OF DOUBLE COUNTING.—

"(i) IN GENERAL.—The applicable percentage of each specified cash position of a specified foreign corporation shall not be taken into account by—

"(I) the United States shareholder referred to in clause (ii) with respect to such position, or

"(II) any United States shareholder which is an includible corporation in the same affiliated group as such United States shareholder referred to in clause (ii).

"(ii) SPECIFIED CASH POSITION.—For purposes of this subparagraph, the term 'specified cash position' means—

"(I) amounts described in subparagraph (B)(ii) to the extent such amounts are receivable from another specified foreign corporation with respect to any United States shareholder,

"(II) amounts described in subparagraph (B)(iii)(I) to the extent such amounts consist of an equity interest in another specified foreign corporation with respect to any United States shareholder, and

"(III) amounts described in subparagraph (B)(iii)(IV) to the extent that another specified foreign corporation with respect to any United States shareholder is obligated to repay such amount.

"(iii) APPLICABLE PERCENTAGE.—For purposes of this subparagraph, the term 'applicable percentage' means—

"(I) with respect to each specified cash position described in subclause (I) or (III) of clause (ii), the pro rata share of the United States shareholder referred to in clause (ii) with respect to the specified foreign corporation referred to in such clause, and

"(II) with respect to each specified cash position described in clause (ii)(II), the ratio (expressed as a percentage and not in excess of 100 percent) of the United States shareholder's pro rata share of the cash position of the specified foreign corporation referred to in such clause divided by the amount of such specified cash position.

For purposes of this subparagraph, a separate applicable percentage shall be determined under each of subclauses (I) and (II) with respect to each specified foreign corporation referred to in clause (ii) with respect to which a specified cash position is determined for the specified foreign corporation referred to in clause (i).

"(iv) REDUCTION WITH RESPECT TO AFFILIATED GROUP MEMBERS NOT WHOLLY OWNED BY THE AFFILIATED GROUP.—For purposes of clause (i)(II), in the case of an includible corporation the group ownership percentage of which is less than 100 percent (as determined under subsection (b)(4)(F)), the amount not take into account by reason of such clause shall be the group ownership percentage of such amount (determined without regard to this clause).

"(E) CERTAIN BLOCKED ASSETS NOT TAKEN INTO ACCOUNT.—A cash position of a specified foreign corporation shall not be taken into account under subparagraph (A) if such position could not (as of the date that it would otherwise have been taken into account under clause (i), (ii), or (iii) of subparagraph (A)) have been distributed by such specified foreign corporation to United States shareholders of such specified foreign corporation because of currency or other restrictions or limitations imposed under the laws of any foreign country (within the meaning of section 964(b)).

"(F) CASH POSITIONS OF CERTAIN NON-CORPORATE ENTITIES TAKEN INTO ACCOUNT.—An entity (other than a domestic corporation) shall be treated as a specified foreign corporation of a United States shareholder for purposes of determining such United States shareholder's aggregate foreign cash position if any interest in such entity is held by a specified foreign corporation of such United States shareholder (determined after application of this subparagraph) and such entity would be a specified foreign corporation of such United States shareholder if such entity were a foreign corporation.

"(G) TIME OF CERTAIN DETERMINATIONS.—For purposes of this paragraph, the determination of whether a person is a United States shareholder, whether a person is a specified foreign corporation, and the pro rata share of a United States shareholder with respect to a specified foreign corporation, shall be determined as of the end of the taxable year described in subsection (a).

"(H) ANTI-ABUSE.—If the Secretary determines that the principal purpose of any transaction was to reduce the aggregate foreign cash position taken into account under this subsection, such transaction shall be disregarded for purposes of this subsection.

"(d) DEFERRED FOREIGN INCOME CORPORATION; ACCUMULATED POST-1986 DEFERRED FOREIGN INCOME.—For purposes of this section—

"(1) DEFERRED FOREIGN INCOME CORPORATION.—The term 'deferred foreign income corporation' means, with respect to any United States shareholder, any specified foreign corporation of such United States shareholder which has accumulated post-1986 deferred foreign income (as of the date referred to in paragraph (1) or (2) of subsection (a), whichever is applicable with respect to such foreign corporation) greater than zero.

"(2) ACCUMULATED POST-1986 DEFERRED FOREIGN INCOME.—The term 'accumulated post-1986 deferred foreign income' means the post-1986 earnings and profits except to the extent such earnings—

"(A) are attributable to income of the specified foreign corporation which is effectively connected with the conduct of a trade or business within the United States and subject to tax under this chapter, or

"(B) if distributed, would be excluded from the gross income of a United States shareholder under section 959.

To the extent provided in regulations or other guidance prescribed by the Secretary, in the case of any controlled foreign corporation which has shareholders which are not United States shareholders, accumulated post-1986 deferred foreign income shall be appropriately reduced by amounts which would be described in subparagraph (B) if such shareholders were United States shareholders.

"(3) POST-1986 EARNINGS AND PROFITS.—The term 'post-1986 earnings and profits' means the earnings and profits of the foreign corporation (computed in accordance with sections 964(a) and 986) accumulated in taxable years beginning after December 31, 1986, and determined—

"(A) as of the date referred to in paragraph (1) or (2) of subsection (a), whichever is applicable with respect to such foreign corporation,

"(B) without diminution by reason of dividends distributed during the taxable year ending with or including such date, and

"(C) increased by the amount of any qualified deficit (within the meaning of section 952(c)(1)(B)(ii)) arising before January 1, 2018, which is treated as a qualified deficit (within the meaning of such section as amended by the Tax Cuts and Jobs Act) for purposes of such foreign corporation's first taxable year beginning after December 31, 2017.

"(e) SPECIFIED FOREIGN CORPORATION.—

"(1) IN GENERAL.—For purposes of this section, the term 'specified foreign corporation' means—

"(A) any controlled foreign corporation, and

"(B) any foreign corporation with respect to which one or more domestic corporations is a United States shareholder (determined without regard to section 958(b)(4)).

"(2) APPLICATION TO CERTAIN FOREIGN CORPORATIONS.—For purposes of sections 951 and 961, a foreign corporation described in paragraph (1)(B) shall be treated as a controlled foreign corporation solely for purposes of taking into account the subpart F income of such corporation under subsection (a) (and for purposes of applying subsection (f)).

"(3) EXCEPTION FOR PASSIVE FOREIGN INVESTMENT COMPANIES.—The term 'specified foreign corporation' shall not include any passive foreign investment company (within the meaning of subpart D of part VI of subchapter P) that is not a controlled foreign corporation.

"(f) DETERMINATIONS OF PRO RATA SHARE.—For purposes of this section, the determination of any United States shareholder's pro rata share of any amount with respect to any specified foreign corporation shall be determined under rules similar to the rules of section 951(a)(2) by treating such amount in the same manner as subpart F income (and by treating such specified foreign corporation as a controlled foreign corporation).

"(g) DISALLOWANCE OF FOREIGN TAX CREDIT, ETC.—

"(1) IN GENERAL.—No credit shall be allowed under section 901 for the applicable percentage of any taxes paid or accrued (or treated as paid or accrued) with respect to any amount for which a deduction is allowed under this section.

"(2) APPLICABLE PERCENTAGE.—For purposes of this subsection, the term 'applicable percentage' means the amount (expressed as a percentage) equal to the sum of—

"(A) 80 percent of the ratio of—

"(i) the excess to which subsection (c)(1)(A) applies, divided by

"(ii) the sum of such excess plus the amount to which subsection (c)(1)(B) applies, plus

"(B) 60 percent of the ratio of—

"(i) the amount to which subsection (c)(1)(B) applies, divided by

"(ii) the sum described in subparagraph (A)(ii).

"(3) DENIAL OF DEDUCTION.—No deduction shall be allowed under this chapter for any tax for which credit is not allowable under section 901 by reason of paragraph (1) (determined by treating the taxpayer as having elected the benefits of subpart A of part III of subchapter N).

"(4) COORDINATION WITH SECTION 78.—With respect to the taxes treated as paid or accrued by a domestic corporation with respect to amounts which are includible in gross income of such domestic corporation by reason of this section, section 78 shall apply only to so much of such taxes as bears the same proportion to the amount of such taxes as—

"(A) the excess of—

"(i) the amounts which are includible in gross income of such domestic corporation by reason of this section, over

"(ii) the deduction allowable under subsection (c) with respect to such amounts, bears to

"(B) such amounts.

"(5) EXTENSION OF FOREIGN TAX CREDIT CARRYOVER PERIOD.—With respect to any taxes paid or accrued (or treated as paid or accrued) with respect to any amount for which a deduction is allowed under this section, section 904(c) shall be applied by substituting 'first 20 succeeding taxable years' for 'first 10 succeeding taxable years'.

"(h) ELECTION TO PAY LIABILITY IN INSTALLMENTS.—

"(1) IN GENERAL.—In the case of a United States shareholder of a deferred foreign income corporation, such United States shareholder may elect to pay the net tax liability under this section in 8 equal installments.

"(2) DATE FOR PAYMENT OF INSTALLMENTS.—If an election is made under paragraph (1), the first installment shall be paid on the due date (determined without regard to any extension of time for filing the return) for the return of tax for the taxable year described in subsection (a) and each succeeding installment shall be paid on the due date (as so determined) for the return of tax for the taxable year following the taxable year with respect to which the preceding installment was made.

"(3) ACCELERATION OF PAYMENT.—If there is an addition to tax for failure to timely pay any installment required under this subsection, a liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), a cessation of business by the taxpayer, or any similar circumstance, then the unpaid portion of all remaining installments shall be due on the date of such event (or in the case of a title 11 or similar case, the day before the petition is filed). The preceding sentence shall not apply to the sale of substantially all the assets of a taxpayer to a buyer if such buyer enters into an agreement with the Secretary under which such buyer is liable for the remaining installments due under this subsection in the same manner as if such buyer were the taxpayer.

"(4) PRORATION OF DEFICIENCY TO INSTALLMENTS.—If an election is made under paragraph (1) to pay the net tax liability under this section in installments and a deficiency has been assessed with respect to such net tax liability, the deficiency shall be prorated to the installments payable under paragraph (1). The part of the deficiency so prorated to any installment the date for payment of which has not arrived shall be collected at the same time as, and as a part of, such installment. The part of the deficiency so prorated to any installment the date for payment of which has arrived shall be paid upon notice and demand from the Secretary. This subsection shall not apply if the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.

"(5) ELECTION.—Any election under paragraph (1) shall be made not later than the due date for the return of tax for the taxable year described in subsection (a) and shall be made in such manner as the Secretary may provide.

"(6) NET TAX LIABILITY UNDER THIS SECTION.—For purposes of this subsection—

"(A) IN GENERAL.—The net tax liability under this section with respect to any United States shareholder is the excess (if any) of—

"(i) such taxpayer's net income tax for the taxable year in which an amount is included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section, over

"(ii) such taxpayer's net income tax for such taxable year determined—

"(I) without regard to this section, and

"(II) without regard to any income, deduction, or credit, properly attributable to a dividend received by such United States shareholder from any deferred foreign income corporation.

"(B) NET INCOME TAX.—The term 'net income tax' means the regular tax liability reduced by the credits allowed under subparts A, B, and D of part IV of subchapter A.

"(i) SPECIAL RULES FOR S CORPORATION SHAREHOLDERS.—

"(1) IN GENERAL.—In the case of any S corporation which is a United States shareholder of a deferred foreign income corporation, each shareholder of such S corporation may elect to defer payment of such shareholder's net tax liability under this section with respect to such S corporation until the shareholder's taxable year which includes the triggering event with respect to such liability. Any net tax liability payment of which is deferred under the preceding sentence shall be assessed on the return as an addition to tax in the shareholder's taxable year which includes such triggering event.

"(2) TRIGGERING EVENT.—

"(A) IN GENERAL.—In the case of any shareholder's net tax liability under this section with respect to any S corporation, the triggering event with respect to such liability is whichever of the following occurs first:

"(i) Such corporation ceases to be an S corporation (determined as of the first day of the first taxable year that such corporation is not an S corporation).

"(ii) A liquidation or sale of substantially all the assets of such S corporation (including in a title 11 or similar case), a cessation of business by such S corporation, such S corporation ceases to exist, or any similar circumstance.

"(iii) A transfer of any share of stock in such S corporation by the taxpayer (including by reason of death, or otherwise).

"(B) PARTIAL TRANSFERS OF STOCK.—In the case of a transfer of less than all of the taxpayer's shares of stock in the S corporation, such transfer shall only be a triggering event with respect to so much of the taxpayer's net tax liability under this section with respect to such S corporation as is properly allocable to such stock.

"(C) TRANSFER OF LIABILITY.—A transfer described in clause (iii) shall not be treated as a triggering event if the transferee enters into an agreement with the Secretary under which such transferee is liable for net tax liability with respect to such stock in the same manner as if such transferee were the taxpayer.

"(3) NET TAX LIABILITY.—A shareholder's net tax liability under this section with respect to any S corporation is the net tax liability under this section which would be determined under subsection (h)(6) if the only subpart F income taken into account by such shareholder by reason of this section were allocations from such S corporation.

"(4) ELECTION TO PAY DEFERRED LIABILITY IN INSTALLMENTS.—In the case of a taxpayer which elects to defer payment under paragraph (1)—

"(A) subsection (h) shall be applied separately with respect to the liability to which such election applies,

"(B) an election under subsection (h) with respect to such liability shall be treated as timely made if made not later than the due date for the return of tax for the taxable year in which the triggering event with respect to such liability occurs,

"(C) the first installment under subsection (h) with respect to such liability shall be paid not later than such due date (but determined without regard to any extension of time for filing the return), and

"(D) if the triggering event with respect to any net tax liability is described in paragraph (2)(A)(ii), an election under subsection (h) with respect to such liability may be made only with the consent of the Secretary.

"(5) JOINT AND SEVERAL LIABILITY OF S CORPORATION.—If any shareholder of an S corporation elects to defer payment under paragraph (1), such S corporation shall be jointly and severally liable for such payment and any penalty, addition to tax, or additional amount attributable thereto.

"(6) EXTENSION OF LIMITATION ON COLLECTION.—Notwithstanding any other provision of law, any limitation on the time period for the collection of a liability deferred under this subsection shall not be treated as beginning before the date of the triggering event with respect to such liability.

"(7) ANNUAL REPORTING OF NET TAX LIABILITY.—

"(A) IN GENERAL.—Any shareholder of an S corporation which makes an election under paragraph (1) shall report the amount of such shareholder's deferred net tax liability on such shareholder's return of tax for the taxable year for which such election is made and on the return of tax for each taxable year thereafter until such amount has been fully assessed on such returns.

"(B) DEFERRED NET TAX LIABILITY.—For purposes of this paragraph, the term 'deferred net tax liability' means, with respect to any taxable year, the amount of net tax liability payment of which has been deferred under paragraph (1) and which has not been assessed on a return of tax for any prior taxable year.

"(C) FAILURE TO REPORT.—In the case of any failure to report any amount required to be reported under subparagraph (A) with respect to any taxable year before the due date for the return of tax for such taxable year, there shall be assessed on such return as an addition to tax 5 percent of such amount.

"(8) ELECTION.—Any election under paragraph (1)—

"(A) shall be made by the shareholder of the S corporation not later than the due date for such shareholder's return of tax for the taxable year which includes the close of the taxable year of such S corporation in which the amount described in subsection (a) is taken into account, and

"(B) shall be made in such manner as the Secretary may provide.

"(j) REPORTING BY S CORPORATION.—Each S corporation which is a United States shareholder of a deferred foreign income corporation shall report in its return of tax under section 6037(a) the amount includible in its gross income for such taxable year by reason of this section and the amount of the deduction allowable by subsection (c). Any copy provided to a shareholder under section 6037(b) shall include a statement of such shareholder's pro rata share of such amounts.

"(k) INCLUSION OF DEFERRED FOREIGN INCOME UNDER THIS SECTION NOT TO TRIGGER RECAPTURE OF OVERALL FOREIGN LOSS, ETC.—For purposes of sections 904(f)(1) and 907(c)(4), in the case of a United States shareholder of a deferred foreign income corporation, such United States shareholder's taxable income from sources without the United States and combined foreign oil and gas income shall be determined without regard to this section.

"(l) REGULATIONS.—The Secretary may prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.".

(b) CLERICAL AMENDMENT.—The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 965 and inserting the following:

"Sec. 965. Treatment of deferred foreign income upon transition to participation exemption system of taxation.".

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.

(a) REPEAL OF SECTION 902 INDIRECT FOREIGN TAX CREDITS.—Subpart A of part III of subchapter N of chapter 1 is amended by striking section 902.

(b) DETERMINATION OF SECTION 960 CREDIT ON CURRENT YEAR BASIS.—Section 960 is amended—

(1) by striking subsection (c), by redesignating subsection (b) as subsection (c), by striking all that precedes subsection (c) (as so redesignated) and inserting the following:

"SEC. 960. DEEMED PAID CREDIT FOR SUBPART F INCLUSIONS.

"(a) IN GENERAL.—For purposes of this subpart, if there is included in the gross income of a domestic corporation any item of income under section 951(a)(1) with respect to any controlled foreign corporation with respect to which such domestic corporation is a United States shareholder, such domestic corporation shall be deemed to have paid so much of such foreign corporation's foreign income taxes as are properly attributable to such item of income.

"(b) SPECIAL RULES FOR DISTRIBUTIONS FROM PREVIOUSLY TAXED EARNINGS AND PROFITS.—For purposes of this subpart—

"(1) IN GENERAL.—If any portion of a distribution from a controlled foreign corporation to a domestic corporation which is a United States shareholder with respect to such controlled foreign corporation is excluded from gross income under section 959(a), such domestic corporation shall be deemed to have paid so much of such foreign corporation's foreign income taxes as—

"(A) are properly attributable to such portion, and

"(B) have not been deemed to have to been paid by such domestic corporation under this section for the taxable year or any prior taxable year.

"(2) TIERED CONTROLLED FOREIGN CORPORATIONS.—If section 959(b) applies to any portion of a distribution from a controlled foreign corporation to another controlled foreign corporation, such controlled foreign corporation shall be deemed to have paid so much of such other controlled foreign corporation's foreign income taxes as—

"(A) are properly attributable to such portion, and

"(B) have not been deemed to have been paid by a domestic corporation under this section for the taxable year or any prior taxable year.",

(2) and by adding after subsection (c) (as so redesignated) the following new subsections:

"(d) FOREIGN INCOME TAXES.—The term 'foreign income taxes' means any income, war profits, or excess profits taxes paid or accrued to any foreign country or possession of the United States.

"(e) REGULATIONS.—The Secretary may prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.".

(c) CONFORMING AMENDMENTS.—

(1) Section 78 is amended to read as follows:

"SEC. 78. GROSS UP FOR DEEMED PAID FOREIGN TAX CREDIT.

"If a domestic corporation chooses to have the benefits of subpart A of part III of subchapter N (relating to foreign tax credit) for any taxable year, an amount equal to the taxes deemed to be paid by such corporation under subsections (a) and (b) of section 960 for such taxable year shall be treated for purposes of this title (other than sections 959, 960, and 961) as an item of income required to be included in the gross income of such domestic corporation under section 951(a) for such taxable year.".

(2) Section 245(a)(10)(C) is amended by striking "sections 902, 907, and 960" and inserting "sections 907 and 960".

(3) Sections 535(b)(1) and 545(b)(1) are each amended by striking "section 902(a) or 960(a)(1)" and inserting "section 960".

(4) Section 814(f)(1) is amended—

(A) by striking subparagraph (B), and

(B) by striking all that precedes "No income" and inserting the following: "(1) TREATMENT OF FOREIGN TAXES.—".

(5) Section 865(h)(1)(B) is amended by striking "sections 902, 907, and 960" and inserting "sections 907 and 960".

(6) Section 901(a) is amended by striking "sections 902 and 960" and inserting "section 960".

(7) Section 901(e)(2) is amended by striking "but is not limited to—" and all that follows through "that portion" and inserting "but is not limited to, that portion".

(8) Section 901(f) is amended by striking "sections 902 and 960" and inserting "section 960".

(9) Section 901(j)(1)(A) is amended by striking "902 or".

(10) Section 901(j)(1)(B) is amended by striking "sections 902 and 960" and inserting "section 960".

(11) Section 901(k)(2) is amended by striking "section 853, 902, or 960" and inserting "section 853 or 960".

(12) Section 901(k)(6) is amended by striking "902 or".

(13) Section 901(m)(1) is amended by striking "relevant foreign assets—" and all that follows and inserting "relevant foreign assets shall not be taken into account in determining the credit allowed under subsection (a).".

(14) Section 904(d)(1) is amended by striking "sections 902, 907, and 960" and inserting "sections 907 and 960".

(15) Section 904(d)(6)(A) is amended by striking "sections 902, 907, and 960" and inserting "sections 907 and 960".

(16) Section 904(h)(10)(A) is amended by striking "sections 902, 907, and 960" and inserting "sections 907 and 960".

(17) Section 904 is amended by striking subsection (k).

(18) Section 905(c)(1) is amended by striking the last sentence.

(19) Section 905(c)(2)(B)(i) is amended to read as follows:

"(i) shall be taken into account for the taxable year to which such taxes relate, and".

(20) Section 906(a) is amended by striking "(or deemed, under section 902, paid or accrued during the taxable year)".

(21) Section 906(b) is amended by striking paragraphs (4) and (5).

(22) Section 907(b)(2)(B) is amended by striking "902 or".

(23) Section 907(c)(3) is amended—

(A) by striking subparagraph (A) and redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively, and

(B) by striking "section 960(a)" in subparagraph (A) (as so redesignated) and inserting "section 960".

(24) Section 907(c)(5) is amended by striking "902 or".

(25) Section 907(f)(2)(B)(i) is amended by striking "902 or".

(26) Section 908(a) is amended by striking "902 or".

(27) Section 909(b) is amended—

(A) by striking "section 902 corporation" in the matter preceding paragraph (1) and inserting "10/50 corporation",

(B) by striking "902 or" in paragraph (1),

(C) by striking "by such section 902 corporation" and all that follows in the matter following paragraph (2) and inserting "by such 10/50 corporation or a domestic corporation which is a United States shareholder with respect to such 10/50 corporation.", and

(D) by striking "SECTION 902 CORPORATIONS" in the heading thereof and inserting "10/50 CORPORATIONS".

(28) Section 909(d)(5) is amended to read as follows:

"(5) 10/50 CORPORATION.—The term '10/50 corporation' means any foreign corporation with respect to which one or more domestic corporations is a United States shareholder.".

(29) Section 958(a)(1) is amended by striking "960(a)(1)" and inserting "960".

(30) Section 959(d) is amended by striking "Except as provided in section 960(a)(3), any" and inserting "Any".

(31) Section 959(e) is amended by striking "section 960(b)" and inserting "section 960(c)".

(32) Section 1291(g)(2)(A) is amended by striking "any distribution—" and all that follows through "but only if" and inserting "any distribution, any withholding tax imposed with respect to such distribution, but only if".

(33) Section 6038(c)(1)(B) is amended by striking "sections 902 (relating to foreign tax credit for corporate stockholder in foreign corporation) and 960 (relating to special rules for foreign tax credit)" and inserting "section 960".

(34) Section 6038(c)(4) is amended by striking subparagraph (C).

(35) The table of sections for subpart A of part III of subchapter N of chapter 1 is amended by striking the item relating to section 902.

(36) The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 960 and inserting the following:

"Sec. 960. Deemed paid credit for subpart F inclusions.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 4102. SOURCE OF INCOME FROM SALES OF INVENTORY DETERMINED SOLELY ON BASIS OF PRODUCTION ACTIVITIES.

(a) IN GENERAL.—Section 863(b) is amended by adding at the end the following: "Gains, profits, and income from the sale or exchange of inventory property described in paragraph (2) shall be allocated and apportioned between sources within and without the United States solely on the basis of the production activities with respect to the property.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle C—Modification of Subpart F Provisions

SEC. 4201. REPEAL OF INCLUSION BASED ON WITHDRAWAL OF PREVIOUSLY EXCLUDED SUBPART F INCOME FROM QUALIFIED INVESTMENT.

(a) IN GENERAL.—Subpart F of part III of subchapter N of chapter 1 is amended by striking section 955.

(b) CONFORMING AMENDMENTS.—

(1)(A) Section 951(a)(1)(A) is amended to read as follows:

"(A) his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year, and".

(B) Section 851(b)(3) is amended by striking "section 951(a)(1)(A)(i)" in the flush language at the end and inserting "section 951(a)(1)(A)".

(C) Section 952(c)(1)(B)(i) is amended by striking "section 951(a)(1)(A)(i)" and inserting "section 951(a)(1)(A)".

(D) Section 953(c)(1)(C) is amended by striking "section 951(a)(1)(A)(i)" and inserting "section 951(a)(1)(A)".

(2) Section 951(a) is amended by striking paragraph (3).

(3) Section 953(d)(4)(B)(iv)(II) is amended by striking "or amounts referred to in clause (ii) or (iii) of section 951(a)(1)(A)".

(4) Section 964(b) is amended by striking ", 955,".

(5) Section 970 is amended by striking subsection (b).

(6) The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 955.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 4202. REPEAL OF TREATMENT OF FOREIGN BASE COMPANY OIL RELATED INCOME AS SUBPART F INCOME.

(a) IN GENERAL.—Section 954(a) is amended by striking paragraph (5), by striking the comma at the end of paragraph (3) and inserting a period, and by inserting "and" at the end of paragraph (2).

(b) CONFORMING AMENDMENTS.—

(1) Section 952(c)(1)(B)(iii) is amended by striking subclause (I) and by redesignating subclauses (II) through (V) as subclauses (I) through (IV), respectively.

(2) Section 954(b)(4) is amended by striking the last sentence.

(3) Section 954(b)(5) is amended by striking "the foreign base company services income, and the foreign base company oil related income" and inserting "and the foreign base company services income".

(4) Section 954(b) is amended by striking paragraph (6).

(5) Section 954 is amended by striking subsection (g).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 4203. INFLATION ADJUSTMENT OF DE MINIMIS EXCEPTION FOR FOREIGN BASE COMPANY INCOME.

(a) IN GENERAL.—Section 954(b)(3) is amended by adding at the end the following new subparagraph:

"(D) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2017, the dollar amount in subparagraph (A)(ii) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(c)(2)(A) for the calendar year in which the taxable year begins.

Any increase determined under the preceding sentence shall be rounded to the nearest multiple of $50,000.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 4204. LOOK-THRU RULE FOR RELATED CONTROLLED FOREIGN CORPORATIONS MADE PERMANENT.

(a) IN GENERAL.—Paragraph (6) of section 954(c) is amended by striking subparagraph (C).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2019, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 4205. MODIFICATION OF STOCK ATTRIBUTION RULES FOR DETERMINING STATUS AS A CONTROLLED FOREIGN CORPORATION.

(a) IN GENERAL.—Section 958(b) is amended—

(1) by striking paragraph (4), and

(2) by striking "Paragraphs (1) and (4)" in the last sentence and inserting "Paragraph (1)".

(b) APPLICATION OF CERTAIN REPORTING REQUIREMENTS.—Section 6038(e)(2) is amended by striking "except that—" and all that follows through "in applying subparagraph (C)" and inserting "except that in applying subparagraph (C)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 4206. ELIMINATION OF REQUIREMENT THAT CORPORATION MUST BE CONTROLLED FOR 30 DAYS BEFORE SUBPART F INCLUSIONS APPLY.

(a) IN GENERAL.—Section 951(a)(1) is amended by striking "for an uninterrupted period of 30 days or more" and inserting "at any time".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Subtitle D—Prevention of Base Erosion

SEC. 4301. CURRENT YEAR INCLUSION BY UNITED STATES SHAREHOLDERS WITH FOREIGN HIGH RETURNS.

(a) IN GENERAL.—Subpart F of part III of subchapter N of chapter 1 is amended by inserting after section 951 the following new section:

"SEC. 951A. FOREIGN HIGH RETURN AMOUNT INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.

"(a) IN GENERAL.—Each person who is a United States shareholder of any controlled foreign corporation for any taxable year of such United States shareholder shall include in gross income for such taxable year 50 percent of such shareholder's foreign high return amount for such taxable year.

"(b) FOREIGN HIGH RETURN AMOUNT.—For purposes of this section—

"(1) IN GENERAL.—The term 'foreign high return amount' means, with respect to any United States shareholder for any taxable year of such United States shareholder, the excess (if any) of—

"(A) such shareholder's net CFC tested income for such taxable year, over

"(B) the excess (if any) of—

"(i) the applicable percentage of the aggregate of such shareholder's pro rata share of the qualified business asset investment of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year (determined for each taxable year of each such controlled foreign corporation which ends in or with such taxable year of such United States shareholder), over

"(ii) the amount of interest expense taken into account under subsection (c)(2)(A)(ii) in determining the shareholder's net CFC tested income for the taxable year.

"(2) APPLICABLE PERCENTAGE.—The term 'applicable percentage' means, with respect to any taxable year, the Federal short-term rate (determined under section 1274(d) for the month in which or with which such taxable year ends) plus 7 percentage points.

"(c) NET CFC TESTED INCOME.—For purposes of this section—

"(1) IN GENERAL.—The term 'net CFC tested income' means, with respect to any United States shareholder for any taxable year of such United States shareholder, the excess (if any) of—

"(A) the aggregate of such shareholder's pro rata share of the tested income of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year of such United States shareholder (determined for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such United States shareholder), over

"(B) the aggregate of such shareholder's pro rata share of the tested loss of each controlled foreign corporation with respect to which such shareholder is a United States shareholder for such taxable year of such United States shareholder (determined for each taxable year of such controlled foreign corporation which ends in or with such taxable year of such United States shareholder).

"(2) TESTED INCOME; TESTED LOSS.—For purposes of this section—

"(A) TESTED INCOME.—The term 'tested income' means, with respect to any controlled foreign corporation for any taxable year of such controlled foreign corporation, the excess (if any) of—

"(i) the gross income of such corporation determined without regard to—

"(I) any item of income which is effectively connected with the conduct by such corporation of a trade or business within the United States if subject to tax under this chapter,

"(II) any gross income taken into account in determining the subpart F income of such corporation,

"(III) except as otherwise provided by the Secretary, any amount excluded from the foreign personal holding company income (as defined in section 954) of such corporation by reason of section 954(c)(6) but only to the extent that any deduction allowable for the payment or accrual of such amount does not result in a reduction in the foreign high return amount of any United States shareholder (determined without regard to this subclause),

"(IV) any gross income excluded from the foreign personal holding company income (as defined in section 954) of such corporation by reason of subsection (c)(2)(C), (h), or (i) of section 954,

"(V) any gross income excluded from the insurance income (as defined in section 953) of such corporation by reason of section 953(a)(2),

"(VI) any gross income excluded from foreign base company income (as defined in section 954) or insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4),

"(VII) any dividend received from a related person (as defined in section 954(d)(3)), and

"(VIII) any commodities gross income of such corporation, over

"(ii) the deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5) (or which would be so properly allocable if such corporation had such gross income).

"(B) TESTED LOSS.—The term 'tested loss' means, with respect to any controlled foreign corporation for any taxable year of such controlled foreign corporation, the excess (if any) of the amount described in subparagraph (A)(ii) over the amount described in subparagraph (A)(i).

"(d) QUALIFIED BUSINESS ASSET INVESTMENT.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified business asset investment' means, with respect to any controlled foreign corporation for any taxable year of such controlled foreign corporation, the aggregate of the corporation's adjusted bases (determined as of the close of such taxable year and after any adjustments with respect to such taxable year) in specified tangible property—

"(A) used in a trade or business of the corporation, and

"(B) of a type with respect to which a deduction is allowable under section 168.

"(2) SPECIFIED TANGIBLE PROPERTY.—The term 'specified tangible property' means any tangible property to the extent such property is used in the production of tested income or tested loss.

"(3) PARTNERSHIP PROPERTY.—For purposes of this subsection, if a controlled foreign corporation holds an interest in a partnership at the close of such taxable year of the controlled foreign corporation, such controlled foreign corporation shall take into account under paragraph (1) the controlled foreign corporation's distributive share of the aggregate of the partnership's adjusted bases (determined as of such date in the hands of the partnership) in tangible property held by such partnership to the extent such property—

"(A) is used in the trade or business of the partnership,

"(B) is of a type with respect to which a deduction is allowable under section 168, and

"(C) is used in the production of tested income or tested loss (determined with respect to such controlled foreign corporation's distributive share of income or loss with respect to such property).

For purposes of this paragraph, the controlled foreign corporation's distributive share of the adjusted basis of any property shall be the controlled foreign corporation's distributive share of income and loss with respect to such property.

"(4) DETERMINATION OF ADJUSTED BASIS.—For purposes of this subsection, the adjusted basis in any property shall be determined without regard to any provision of this title (or any other provision of law) which is enacted after the date of the enactment of this section.

"(5) REGULATIONS.—The Secretary shall issue such regulations or other guidance as the Secretary determines appropriate to prevent the avoidance of the purposes of this subsection, including regulations or other guidance which provide for the treatment of property if—

"(A) such property is transferred, or held, temporarily, or

"(B) the avoidance of the purposes of this paragraph is a factor in the transfer or holding of such property.

"(e) COMMODITIES GROSS INCOME.—For purposes of this section—

"(1) COMMODITIES GROSS INCOME.—The term 'commodities gross income' means, with respect to any corporation—

"(A) gross income of such corporation from the disposition of commodities which are produced or extracted by such corporation (or a partnership in which such corporation is a partner), and

"(B) gross income of such corporation from the disposition of property which gives rise to income described in subparagraph (A).

"(2) COMMODITY.—The term 'commodity' means any commodity described in section 475(e)(2)(A) or section 475(e)(2)(D) (determined without regard to clause (i) thereof and by substituting 'a commodity described in subparagraph (A)' for 'such a commodity' in clause (ii) thereof).

"(f) TAXABLE YEARS FOR WHICH PERSONS ARE TREATED AS UNITED STATES SHAREHOLDERS OF CONTROLLED FOREIGN CORPORATIONS.—For purposes of this section—

"(1) IN GENERAL.—A United States shareholder of a controlled foreign corporation shall be treated as a United States shareholder of such controlled foreign corporation for any taxable year of such United States shareholder if—

"(A) a taxable year of such controlled foreign corporation ends in or with such taxable year of such person, and

"(B) such person owns (within the meaning of section 958(a)) stock in such controlled foreign corporation on the last day, in such taxable year of such foreign corporation, on which the foreign corporation is a controlled foreign corporation.

"(2) TREATMENT AS A CONTROLLED FOREIGN CORPORATION.—Except for purposes of paragraph (1)(B) and the application of section 951(a)(2) to this section pursuant to subsection (g), a foreign corporation shall be treated as a controlled foreign corporation for any taxable year of such foreign corporation if such foreign corporation is a controlled foreign corporation at any time during such taxable year.

"(g) DETERMINATION OF PRO RATA SHARE.—For purposes of this section, pro rata shares shall be determined under the rules of section 951(a)(2) in the same manner as such section applies to subpart F income.

"(h) COORDINATION WITH SUBPART F.—

"(1) TREATMENT AS SUBPART F INCOME FOR CERTAIN PURPOSES.—Except as otherwise provided by the Secretary any foreign high return amount included in gross income under subsection (a) shall be treated in the same manner as an amount included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4).

"(2) ENTIRE FOREIGN HIGH RETURN AMOUNT TAKEN INTO ACCOUNT FOR PURPOSES OF CERTAIN SECTIONS.—For purposes of applying paragraph (1) with respect to sections 168(h)(2)(B), 851(b), 959, 961, 962, 1248(b)(1), and 1248(d)(1), the foreign high return amount included in gross income under subsection (a) shall be determined by substituting '100 percent' for '50 percent' in such subsection.

"(3) ALLOCATION OF FOREIGN HIGH RETURN AMOUNT TO CONTROLLED FOREIGN CORPORATIONS.—For purposes of the sections referred to in paragraph (1), with respect to any controlled foreign corporation any pro rata amount from which is taken into account in determining the foreign high return amount included in gross income of a United States shareholder under subsection (a), the portion of such foreign high return amount which is treated as being with respect to such controlled foreign corporation is—

"(A) in the case of a controlled foreign corporation with tested loss, zero, and

"(B) in the case of a controlled foreign corporation with tested income, the portion of such foreign high return amount which bears the same ratio to such foreign high return amount as—

"(i) such United States shareholder's pro rata amount of the tested income of such controlled foreign corporation, bears to

"(ii) the aggregate amount determined under subsection (c)(1)(A) with respect to such United States shareholder.

"(4) COORDINATION WITH SUBPART F TO DENY DOUBLE BENEFIT OF LOSSES.—In the case of any United States shareholder of any controlled foreign corporation, the amount included in gross income under section 951(a)(1)(A) shall be determined by increasing the earnings and profits of such controlled foreign corporation (solely for purposes of determining such amount) by an amount that bears the same ratio (not greater than 1) to such shareholder's pro rata share of the tested loss of such controlled foreign corporation as—

"(A) the aggregate amount determined under subsection (c)(1)(A) with respect to such shareholder, bears to

"(B) the aggregate amount determined under subsection (c)(1)(B) with respect to such shareholder.".

(b) FOREIGN TAX CREDIT.—

(1) APPLICATION OF DEEMED PAID FOREIGN TAX CREDIT.—Section 960, as amended by the preceding provisions of this Act, is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) DEEMED PAID CREDIT FOR TAXES PROPERLY ATTRIBUTABLE TO TESTED INCOME.—

"(1) IN GENERAL.—For purposes of this subpart, if any amount is includible in the gross income of a domestic corporation under section 951A, such domestic corporation shall be deemed to have paid foreign income taxes equal to 80 percent of—

"(A) such domestic corporation's foreign high return percentage, multiplied by

"(B) the aggregate tested foreign income taxes paid or accrued by controlled foreign corporations with respect to which such domestic corporation is a United States shareholder.

"(2) FOREIGN HIGH RETURN PERCENTAGE.—For purposes of paragraph (1), the term 'foreign high return percentage' means, with respect to any domestic corporation, the ratio (expressed as a percentage) of—

"(A) such corporation's foreign high return amount (as defined in section 951A(b)), divided by

"(B) the aggregate amount determined under section 951A(c)(1)(A) with respect to such corporation.

"(3) TESTED FOREIGN INCOME TAXES.—For purposes of paragraph (1), the term 'tested foreign income taxes' means, with respect to any domestic corporation which is a United States shareholder of a controlled foreign corporation, the foreign income taxes paid or accrued by such foreign corporation which are properly attributable to gross income described in section 951A(c)(2)(A)(i).".

(2) APPLICATION OF FOREIGN TAX CREDIT LIMITATION.—

(A) SEPARATE BASKET FOR FOREIGN HIGH RETURN AMOUNT.—Section 904(d)(1) is amended by redesignating subparagraphs (A) and (B) as subparagraphs (B) and (C), respectively, and by inserting before subparagraph (B) (as so redesignated) the following new subparagraph:

"(A) any amount includible in gross income under section 951A,".

(B) NO CARRYOVER OF EXCESS TAXES.—Section 904(c) is amended by adding at the end the following: "This subsection shall not apply to taxes paid or accrued with respect to amounts described in subsection (d)(1)(A)."

(3) GROSS UP FOR DEEMED PAID FOREIGN TAX CREDIT.—Section 78, as amended by the preceding provisions of this Act, is amended—

(A) by striking "any taxable year, an amount" and inserting "any taxable year—

"(1) an amount", and

(B) by striking the period at the end and inserting ", and

"(2) an amount equal to the taxes deemed to be paid by such corporation under section 960(d) for such taxable year (determined by substituting '100 percent' for '80 percent' in such section) shall be treated for purposes of this title (other than sections 959, 960, and 961) as an increase in the foreign high return amount of such domestic corporation under section 951A for such taxable year.".

(c) CONFORMING AMENDMENTS.—

(1) Section 170(b)(2)(D) is amended by striking "computed without regard to" and all that follows and inserting "computed—

"(i) without regard to—

"(I) this section,

"(II) part VIII (except section 248),

"(III) any net operating loss carryback to the taxable year under section 172,

"(IV) any capital loss carryback to the taxable year under section 1212(a)(1), and

"(ii) by substituting '100 percent' for '50 percent' in section 951A(a).".

(2) Section 246(b)(1) is amended by—

(A) striking "and without regard to" and inserting "without regard to", and

(B) by striking the period at the end and inserting ", and by substituting '100 percent' for '50 percent' in section 951A(a).".

(3) Section 469(i)(3)(F) is amended by striking "determined without regard to" and all that follows and inserting "determined—

"(i) without regard to—

"(I) any amount includible in gross income under section 86,

"(II) the amounts allowable as a deduction under section 219, and

"(III) any passive activity loss or any loss allowable by reason of subsection (c)(7), and

"(ii) by substituting '100 percent' for '50 percent' in section 951A(a).".

(4) Section 856(c)(2) is amended by striking "and" at the end of subparagraph (H), by adding "and" at the end of subparagraph (I), and by inserting after subparagraph (I) the following new subparagraph:

"(J) amounts includible in gross income under section 951A(a);".

(5) Section 856(c)(3)(D) is amended by striking "dividends or other distributions on, and gain" and inserting "dividends, other distributions on, amounts includible in gross income under section 951A(a) with respect to, and gain".

(6) The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by inserting after the item relating to section 951 the following new item:

"Sec. 951A. Foreign high return amount included in gross income of United States shareholders.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 4302. LIMITATION ON DEDUCTION OF INTEREST BY DOMESTIC CORPORATIONS WHICH ARE MEMBERS OF AN INTERNATIONAL FINANCIAL REPORTING GROUP.

(a) IN GENERAL.—Section 163 is amended by redesignating subsection (n) as subsection (p) and by inserting after subsection (m) the following new subsection:

"(n) LIMITATION ON DEDUCTION OF INTEREST BY DOMESTIC CORPORATIONS IN INTERNATIONAL FINANCIAL REPORTING GROUPS.—

"(1) IN GENERAL.—In the case of any domestic corporation which is a member of any international financial reporting group, the deduction under this chapter for interest paid or accrued during the taxable year shall not exceed the sum of—

"(A) the allowable percentage of 110 percent of the excess (if any) of —

"(i) the amount of such interest so paid or accrued, over

"(ii) the amount described in subparagraph (B), plus

"(B) the amount of interest includible in gross income of such corporation for such taxable year.

"(2) INTERNATIONAL FINANCIAL REPORTING GROUP.—

"(A) For purposes of this subsection, the term 'international financial reporting group' means, with respect to any reporting year, any group of entities which—

"(i) includes—

"(I) at least one foreign corporation engaged in a trade or business within the United States, or

"(II) at least one domestic corporation and one foreign corporation,

"(ii) prepares consolidated financial statements with respect to such year, and

"(iii) reports in such statements average annual gross receipts (determined in the aggregate with respect to all entities which are part of such group) for the 3-reporting-year period ending with such reporting year in excess of $100,000,000.

"(B) RULES RELATING TO DETERMINATION OF AVERAGE GROSS RECEIPTS.—For purposes of subparagraph (A)(iii), rules similar to the rules of section 448(c)(3) shall apply.

"(3) ALLOWABLE PERCENTAGE.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'allowable percentage' means, with respect to any domestic corporation for any taxable year, the ratio (expressed as a percentage and not greater than 100 percent) of—

"(i) such corporation's allocable share of the international financial reporting group's reported net interest expense for the reporting year of such group which ends in or with such taxable year of such corporation, over

"(ii) such corporation's reported net interest expense for such reporting year of such group.

"(B) REPORTED NET INTEREST EXPENSE.—The term 'reported net interest expense' means—

"(i) with respect to any international financial reporting group for any reporting year, the excess of—

"(I) the aggregate amount of interest expense reported in such group's consolidated financial statements for such taxable year, over

"(II) the aggregate amount of interest income reported in such group's consolidated financial statements for such taxable year, and

"(ii) with respect to any domestic corporation for any reporting year, the excess of—

"(I) the amount of interest expense of such corporation reported in the books and records of the international financial reporting group which are used in preparing such group's consolidated financial statements for such taxable year, over

"(II) the amount of interest income of such corporation reported in such books and records.

"(C) ALLOCABLE SHARE OF REPORTED NET INTEREST EXPENSE.—With respect to any domestic corporation which is a member of any international financial reporting group, such corporation's allocable share of such group's reported net interest expense for any reporting year is the portion of such expense which bears the same ratio to such expense as—

"(i) the EBITDA of such corporation for such reporting year, bears to

"(ii) the EBITDA of such group for such reporting year.

"(D) EBITDA.—

"(i) IN GENERAL.—The term 'EBITDA' means, with respect to any reporting year, earnings before interest, taxes, depreciation, and amortization—

"(I) as determined in the international financial reporting group's consolidated financial statements for such year, or

"(II) for purposes of subparagraph (A)(i), as determined in the books and records of the international financial reporting group which are used in preparing such statements if not determined in such statements.

"(ii) TREATMENT OF DISREGARDED ENTITIES.—The EBITDA of any domestic corporation shall not fail to include the EBITDA of any entity which is disregarded for purposes of this chapter.

"(iii) TREATMENT OF INTRA-GROUP DISTRIBUTIONS.—The EBITDA of any domestic corporation shall be determined without regard to any distribution received by such corporation from any other member of the international financial reporting group.

"(E) SPECIAL RULES FOR NON-POSITIVE EBITDA.—

"(i) NON-POSITIVE GROUP EBITDA.—In the case of any international financial reporting group the EBITDA of which is zero or less, paragraph (1) shall not apply to any member of such group the EBITDA of which is above zero.

"(ii) NON-POSITIVE ENTITY EBITDA.—In the case of any group member the EBITDA of which is zero or less, paragraph (1) shall be applied without regard to subparagraph (A) thereof.

"(4) CONSOLIDATED FINANCIAL STATEMENT.—For purposes of this subsection, the term 'consolidated financial statement' means any consolidated financial statement described in paragraph (2)(A)(ii) if such statement is—

"(A) a financial statement which is certified as being prepared in accordance with generally accepted accounting principles, international financial reporting standards, or any other comparable method of accounting identified by the Secretary, and which is—

"(i) a 10-K (or successor form), or annual statement to shareholders, required to be filed with the United States Securities and Exchange Commission,

"(ii) an audited financial statement which is used for—

"(I) credit purposes,

"(II) reporting to shareholders, partners, or other proprietors, or to beneficiaries, or

"(III) any other substantial nontax purpose,

but only if there is no statement described in clause (i), or

"(iii) filed with any other Federal or State agency for nontax purposes, but only if there is no statement described in clause (i) or (ii), or

"(B) a financial statement which—

"(i) is used for a purpose described in subclause (I), (II), or (III) of subparagraph (A)(ii), or

"(ii) filed with any regulatory or governmental body (whether domestic or foreign) specified by the Secretary,

but only if there is no statement described in subparagraph (A).

"(5) REPORTING YEAR.—For purposes of this subsection, the term 'reporting year' means, with respect to any international financial reporting group, the year with respect to which the consolidated financial statements are prepared.

"(6) APPLICATION TO CERTAIN ENTITIES.—

"(A) PARTNERSHIPS.—Except as otherwise provided by the Secretary in paragraph (7), this subsection shall apply to any partnership which is a member of any international financial reporting group under rules similar to the rules of section 163(j)(3).

"(B) FOREIGN CORPORATIONS ENGAGED IN TRADE OR BUSINESS WITHIN THE UNITED STATES.—Except as otherwise provided by the Secretary in paragraph (8), any deduction for interest paid or accrued by a foreign corporation engaged in a trade or business within the United States shall be limited in a manner consistent with the principles of this subsection.

"(C) CONSOLIDATED GROUPS.—For purposes of this subsection, the members of any group that file (or are required to file) a consolidated return with respect to the tax imposed by chapter 1 for a taxable year shall be treated as a single corporation.

"(7) REGULATIONS.—The Secretary may issue such regulations or other guidance as are necessary or appropriate to carry out the purposes of this subsection.".

(b) CARRYFORWARD OF DISALLOWED INTEREST.—

(1) IN GENERAL.—Section 163(o) is amended to read as follows:

"(o) CARRYFORWARD OF CERTAIN DISALLOWED INTEREST.—The amount of any interest not allowed as a deduction for any taxable year by reason of subsection (j)(1) or (n)(1) (whichever imposes the lower limitation with respect to such taxable year) shall be treated as interest (and as business interest for purposes of subsection (j)(1)) paid or accrued in the succeeding taxable year. Interest paid or accrued in any taxable year (determined without regard to the preceding sentence) shall not be carried past the 5th taxable year following such taxable year, determined by treating interest as allowed as a deduction on a first-in, first-out basis.".

(2) TREATMENT OF CARRYFORWARD OF DISALLOWED INTEREST IN CERTAIN CORPORATE ACQUISITIONS.—For rules related to the carryforward of disallowed interest in certain corporate acquisitions, see the amendments made by section 3301(c).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 4303. EXCISE TAX ON CERTAIN PAYMENTS FROM DOMESTIC CORPORATIONS TO RELATED FOREIGN CORPORATIONS; ELECTION TO TREAT SUCH PAYMENTS AS EFFECTIVELY CONNECTED INCOME.

(a) EXCISE TAX ON CERTAIN AMOUNTS FROM DOMESTIC CORPORATIONS TO FOREIGN AFFILIATES.—

(1) IN GENERAL.—Chapter 36 is amended by adding at the end the following new subchapter:

"Subchapter E—Tax on Certain Amounts to Foreign Affiliates

"SEC. 4491. IMPOSITION OF TAX ON CERTAIN AMOUNTS FROM DOMESTIC CORPORATIONS TO FOREIGN AFFILIATES.

"(a) IN GENERAL.—There is hereby imposed on each specified amount paid or incurred by a domestic corporation to a foreign corporation which is a member of the same international financial reporting group as such domestic corporation a tax equal to the highest rate of tax in effect under section 11 multiplied by such amount.

"(b) BY WHOM PAID.—The tax imposed by subsection (a) shall be paid by the domestic corporation described in such subsection.

"(c) EXCEPTION FOR EFFECTIVELY CONNECTED INCOME.—Subsection (a) shall not apply to so much of any specified amount as is effectively connected with the conduct of a trade or business within the United States if such amount is subject to tax under chapter 1. In the case of any amount which is treated as effectively connected with the conduct of a trade or business within the United States by reason of section 882(g), the preceding sentence shall apply to such amount only if the domestic corporation provides to the Secretary (at such time and in such form and manner as the Secretary may provide) a copy of the election made under section 882(g) by the foreign corporation referred to in subsection (a).

"(d) DEFINITIONS AND SPECIAL RULES.—Terms used in this section that are also used in section 882(g) shall have the same meaning as when used in such section and rules similar to the rules of paragraphs (5) and (6) of such section shall apply for purposes of this section.".

(2) DENIAL OF DEDUCTION FOR TAX IMPOSED.—Section 275(a) is amended by inserting after paragraph (6) the following new paragraph:

"(7) Taxes imposed by section 4491.".

(3) CLERICAL AMENDMENT.—The table of subchapters for chapter 36 is amended by adding at the end the following new item:

"SUBCHAPTER E. TAX ON CERTAIN AMOUNTS TO FOREIGN AFFILIATES.".

(b) ELECTION TO TREAT CERTAIN PAYMENTS FROM DOMESTIC CORPORATIONS TO RELATED FOREIGN CORPORATIONS AS EFFECTIVELY CONNECTED INCOME.—Section 882 is amended by adding at the end the following new subsection:

"(g) ELECTION TO TREAT CERTAIN PAYMENTS FROM DOMESTIC CORPORATIONS TO RELATED FOREIGN CORPORATIONS AS EFFECTIVELY CONNECTED INCOME.—

"(1) IN GENERAL.—In the case of any specified amount paid or incurred by a domestic corporation to a foreign corporation which is a member of the same international financial reporting group as such domestic corporation and which has elected to be subject to the provisions of this subsection—

"(A) such amount shall be taken into account (other than for purposes of sections 245, 245A, and 881) in the taxable year of such foreign corporation during which such amount is paid or incurred as if—

"(i) such foreign corporation were engaged in a trade or business within the United States,

"(ii) such foreign corporation had a permanent establishment in the United States during the taxable year, and

"(iii) such payment were effectively connected with the conduct of a trade or business within the United States and were attributable to such permanent establishment, "(B) for purposes of subsection (c)(1)(A), no deduction shall be allowed with respect to such amount and such subsection shall be applied without regard to such amount, and

"(C) the foreign corporation shall be allowed a deduction (for the taxable year referred to in subparagraph (A)) equal to the deemed expenses with respect to such amount.

"(2) SPECIFIED AMOUNT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'specified amount' means any amount which is, with respect to the payor, allowable as a deduction or includible in costs of goods sold, inventory, or the basis of a depreciable or amortizable asset.

"(B) EXCEPTIONS.—The term 'specified amount' shall not include—

"(i) interest,

"(ii) any amount paid or incurred for the acquisition of any security described in section 475(c)(2) (determined without regard to the last sentence thereof) or any commodity described in section 475(e)(2),

"(iii) except as provided in subparagraph (C), any amount with respect to which tax is imposed under section 881(a), and

"(iv) in the case of a payor which has elected to use a services cost method for purposes of section 482, any amount paid or incurred for services if such amount is the total services cost with no markup.

"(C) AMOUNTS NOT TREATED AS EFFECTIVELY CONNECTED TO EXTENT OF GROSS-BASIS TAX.—Subparagraph (B)(iii) shall only apply to so much of any specified amount as bears the proportion to such amount as—

"(i) the rate of tax imposed under section 881(a) with respect to such amount, bears to

"(ii) 30 percent.

"(3) DEEMED EXPENSES.—

"(A) IN GENERAL.—The deemed expenses with respect to any specified amount received by a foreign corporation during any reporting year is the amount of expenses such that the net income ratio of such foreign corporation with respect to such amount (taking into account only such specified amount and such deemed expenses) is equal to the net income ratio of the international financial reporting group determined for such reporting year with respect to the product line to which the specified amount relates.

"(B) NET INCOME RATIO.—For purposes of this paragraph, the term 'net income ratio' means the ratio of—

"(i) net income determined without regard to interest income, interest expense, and income taxes, divided by

"(ii) revenues.

"(C) METHOD OF DETERMINATION.—Amounts described in subparagraph (B) shall be determined with respect to the international financial reporting group on the basis of the consolidated financial statements referred to in paragraph (4)(A)(i) and the books and records of the members of the international financial reporting group which are used in preparing such statements, taking into account only revenues and expenses of the members of such group (other than the members of such group which are (or are treated as) a domestic corporation for purposes of this subsection) derived from, or incurred with respect to—

"(i) persons who are not members of such group, and

"(ii) members of such group which are (or are treated as) a domestic corporation for purposes of this subsection.

"(4) INTERNATIONAL FINANCIAL REPORTING GROUP.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'international financial reporting group' means any group of entities, with respect to any specified amount, if such amount is paid or incurred during a reporting year of such group with respect to which—

"(i) such group prepares consolidated financial statements (within the meaning of section 163(n)(4)) with respect to such year, and

"(ii) the average annual aggregate payment amount of such group for the 3-reporting-year period ending with such reporting year exceeds $100,000,000.

"(B) ANNUAL AGGREGATE PAYMENT AMOUNT.—The term 'annual aggregate payment amount' means, with respect to any reporting year of the group referred to in subparagraph (A)(i), the aggregate specified amounts to which paragraph (1) applies (or would apply if such group were an international financial reporting group).

"(C) APPLICATION OF CERTAIN RULES.—Rules similar to the rules of subparagraphs (A), (B), and (D) of section 448(c)(3) shall apply for purposes of this paragraph.

"(5) TREATMENT OF PARTNERSHIPS.—Any specified amount paid, incurred, or received by a partnership which is a member of any international financial reporting group (and any amount treated as paid, incurred, or received by a partnership under this paragraph) shall be treated for purposes of this subsection as amounts paid, incurred, or received, respectively, by each partner of such partnership in an amount equal to such partner's distributive share of the items of income, gain, deduction, or loss to which such amounts relate.

"(6) TREATMENT OF AMOUNTS IN CONNECTION WITH UNITED STATES TRADE OR BUSINESS.—Any specified amount paid, incurred, or received by a foreign corporation in connection with the conduct of a trade or business within the United States (other than a trade or business it is deemed to conduct pursuant to this subsection) shall be treated for purposes of this subsection as an amount paid, incurred, or received, respectively, by a domestic corporation. For purposes of the preceding sentence, a foreign corporation shall be deemed to pay, incur, and receive amounts with respect to a trade or business it conducts within the United States (other than a trade or business it is deemed to conduct pursuant to this subsection) to the extent such foreign corporation would be treated as paying, incurring, or receiving such amounts from such trade or business if such trade or business were a domestic corporation.

"(7) JOINT AND SEVERAL LIABILITY OF MEMBERS OF INTERNAL FINANCIAL REPORTING GROUP.—In the case of any underpayment with respect to any taxable year of a foreign corporation which is a member of an international financial accounting group, each domestic corporation which is a member of such group at any time during such taxable year shall be jointly and severally liable for—

"(A) so much of such underpayment as does not exceed the excess (if any) of such underpayment over the amount of such underpayment determined without regard to this subsection, and

"(B) any penalty, addition to tax, or additional amount attributable to the amount described in subparagraph (A).

"(8) FOREIGN TAX CREDIT ALLOWED.—The credit allowed under section 906(a) with respect to amounts taken into account in income under paragraph (1)(A) shall be limited to 80 percent of the amount of taxes paid or accrued and determined without regard to section 906(b)(1).

"(9) ELECTION.—Any election under paragraph (1)—

"(A) shall be made at such time and in such form and manner as the Secretary may provide, and

"(B) shall apply for the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

"(10) REGULATIONS.—The Secretary may issue such regulations or other guidance as are necessary or appropriate to carry out the purposes of this subsection, including regulations or other guidance—

"(A) to provide for the proper determination of product lines, and

"(B) to prevent the avoidance of the purposes of this subsection through the use of conduit transactions or by other means.".

(c) REPORTING REQUIREMENTS.—

(1) REPORTING BY FOREIGN CORPORATION.—Section 6038C(b) is amended to read as follows:

"(b) REQUIRED INFORMATION.—

"(1) IN GENERAL.—The information described in this subsection is—

"(A) the information described in section 6038A(b), and

"(B) such other information as the Secretary may prescribe by regulations relating to any item not directly connected with a transaction for which information is required under subparagraph (A).

"(2) CERTAIN PAYMENTS FROM RELATED DOMESTIC CORPORATIONS.—

"(A) IN GENERAL.—In the case of any reporting corporation that receives during the taxable year any amount to which section 882(g)(1) applies, the information described in this subsection shall include, with respect to each member of the international financial reporting group from which any such amount is received—

"(i) the name and taxpayer identification number of such member,

"(ii) the aggregate amounts received from such member,

"(iii) the product lines to which such amounts relate, the aggregate amounts relating to each such product line, and the net income ratio for each such product line (determined under section 882(g)(3)(B) with respect to the international financial reporting group), and "(iv) a summary of any changes in financial accounting methods that affect the computation of any net income ratio described in clause (iii).

"(B) DEFINITIONS AND SPECIAL RULES.—Terms used in this paragraph that are also used in section 882(g) shall have the same meaning as when used in such section and rules similar to the rules of paragraphs (5) and (6) of such section shall apply for purposes of this paragraph.".

(2) REPORTING BY DOMESTIC GROUP MEMBERS.—

(A) IN GENERAL .—Subpart A of part III of subchapter A of chapter 61 is amended by inserting after section 6038D the following new section:

"SEC. 6038E. INFORMATION WITH RESPECT TO CERTAIN PAYMENTS FROM DOMESTIC CORPORATIONS TO RELATED FOREIGN CORPORATIONS.

"(a) IN GENERAL.—In the case of any domestic corporation which pays or incurs any amount to which section 882(g)(1) applies, such person shall—

"(1) make a return according to the forms and regulations prescribed the Secretary, setting forth the information described in subsection (b), and

"(2) maintain (at the location, in the manner, and to the extent prescribed in regulations) such records as may be appropriate to determine liability for tax pursuant to paragraphs (1) and (7) of section 882(g).

"(b) REQUIRED INFORMATION.—The information described in this subsection is—

"(1) the name and taxpayer identification number of the common parent of the international financial reporting group in which such domestic corporation is a member, and

"(2) with respect to any person who receives an amount described in subsection (a) from such domestic corporation—

"(A) the name and taxpayer identification number of such person,

"(B) the aggregate amounts received by such person,

"(C) the product lines to which such amounts relate, the aggregate amounts relating to each such product line, and the net income ratio for each such product line (determined under section 882(g)(3)(B) with respect to the international financial reporting group), and

"(D) a summary of any changes in financial accounting methods that affect the computation of any net income ratios described in subparagraph (C).

"(c) DEFINITIONS AND SPECIAL RULES.—Terms used in this paragraph that are also used in section 882(g) shall have the same meaning as when used in such section and rules similar to the rules of paragraphs (5) and (6) of such section shall apply for purposes of this paragraph.".

(B) CLERICAL AMENDMENT.—The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6038D the following new item:

"Sec. 6038E. Information with respect to certain payments from domestic corporations to related foreign corporations.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 2018.

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.

(a) IN GENERAL.—Section 199(d)(8)(C), prior to its repeal by this Act, is amended—

(1) by striking "first 11 taxable years" and inserting "first 12 taxable years", and

(2) by striking "January 1, 2017" and inserting "January 1, 2018".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2016.

SEC. 4402. EXTENSION OF TEMPORARY INCREASE IN LIMIT ON COVER OVER OF RUM EXCISE TAXES TO PUERTO RICO AND THE VIRGIN ISLANDS.

(a) IN GENERAL.—Section 7652(f)(1) is amended by striking "January 1, 2017" and inserting "January 1, 2023".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distilled spirits brought into the United States after December 31, 2016.

SEC. 4403. EXTENSION OF AMERICAN SAMOA ECONOMIC DEVELOPMENT CREDIT.

(a) IN GENERAL.—Section 119(d) of division A of the Tax Relief and Health Care Act of 2006 is amended—

(1) by striking "January 1, 2017" each place it appears and inserting "January 1, 2023",

(2) by striking "first 11 taxable years" in paragraph (1) and inserting "first 17 taxable years", and

(3) by striking "first 5 taxable years" in paragraph (2) and inserting "first 11 taxable years".

(b) TREATMENT OF CERTAIN REFERENCES.—Section 119(e) of division A of the Tax Relief and Health Care Act of 2006 is amended by adding at the end the following: "References in this subsection to section 199 of the Internal Revenue Code of 1986 shall be treated as references to such section as in effect before its repeal by the Tax Cuts and Jobs Act.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2016.

Subtitle F—Other International Reforms

SEC. 4501. RESTRICTION ON INSURANCE BUSINESS EXCEPTION TO PASSIVE FOREIGN INVESTMENT COMPANY RULES.

(a) IN GENERAL.—Section 1297(b)(2)(B) is amended to read as follows:

"(B) derived in the active conduct of an insurance business by a qualifying insurance corporation (as defined in subsection (f)),".

(b) QUALIFYING INSURANCE CORPORATION DEFINED.—Section 1297 is amended by adding at the end the following new subsection:

"(f) QUALIFYING INSURANCE CORPORATION.—For purposes of subsection (b)(2)(B)—

"(1) IN GENERAL.—The term 'qualifying insurance corporation' means, with respect to any taxable year, a foreign corporation—

"(A) which would be subject to tax under subchapter L if such corporation were a domestic corporation, and

"(B) the applicable insurance liabilities of which constitute more than 25 percent of its total assets, determined on the basis of such liabilities and assets as reported on the corporation's applicable financial statement for the last year ending with or within the taxable year.

"(2) ALTERNATIVE FACTS AND CIRCUMSTANCES TEST FOR CERTAIN CORPORATIONS.—If a corporation fails to qualify as a qualified insurance corporation under paragraph (1) solely because the percentage determined under paragraph (1)(B) is 25 percent or less, a United States person that owns stock in such corporation may elect to treat such stock as stock of a qualifying insurance corporation if—

"(A) the percentage so determined for the corporation is at least 10 percent, and

"(B) under regulations provided by the Secretary, based on the applicable facts and circumstances—

"(i) the corporation is predominantly engaged in an insurance business, and

"(ii) such failure is due solely to runoff-related or rating-related circumstances involving such insurance business.

"(3) APPLICABLE INSURANCE LIABILITIES.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'applicable insurance liabilities' means, with respect to any life or property and casualty insurance business—

"(i) loss and loss adjustment expenses, and

"(ii) reserves (other than deficiency, contingency, or unearned premium reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks.

"(B) LIMITATIONS ON AMOUNT OF LIABILITIES.—Any amount determined under clause (i) or (ii) of subparagraph (A) shall not exceed the lesser of such amount—

"(i) as reported to the applicable insurance regulatory body in the applicable financial statement described in paragraph (4)(A) (or, if less, the amount required by applicable law or regulation), or

"(ii) as determined under regulations prescribed by the Secretary.

"(4) OTHER DEFINITIONS AND RULES.—For purposes of this subsection—

"(A) APPLICABLE FINANCIAL STATEMENT.—The term 'applicable financial statement' means a statement for financial reporting purposes which—

"(i) is made on the basis of generally accepted accounting principles, "(ii) is made on the basis of international financial reporting standards, but only if there is no statement that meets the requirement of clause (i), or

"(iii) except as otherwise provided by the Secretary in regulations, is the annual statement which is required to be filed with the applicable insurance regulatory body, but only if there is no statement which meets the requirements of clause (i) or (ii).

"(B) APPLICABLE INSURANCE REGULATORY BODY.—The term 'applicable insurance regulatory body' means, with respect to any insurance business, the entity established by law to license, authorize, or regulate such business and to which the statement described in subparagraph (A) is provided.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

TITLE V—EXEMPT ORGANIZATIONS

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).

(a) IN GENERAL.—Section 511 is amended by adding at the end the following new subsection:

"(d) ORGANIZATIONS AND TRUSTS EXEMPT FROM TAXATION NOT SOLELY BY REASON OF SECTION 501(a).—For purposes of subsections (a)(2) and (b)(2), an organization or trust shall not fail to be treated as exempt from taxation under this subtitle by reason of section 501(a) solely because such organization is also so exempt, or excludes amounts from gross income, by reason of any other provision of this title.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 5002. EXCLUSION OF RESEARCH INCOME LIMITED TO PUBLICLY AVAILABLE RESEARCH.

(a) IN GENERAL.—Section 512(b)(9) is amended by striking "from research" and inserting "from such research".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle B—Excise Taxes

SEC. 5101. SIMPLIFICATION OF EXCISE TAX ON PRIVATE FOUNDATION INVESTMENT INCOME.

(a) RATE REDUCTION.—Section 4940(a) is amended by striking "2 percent" and inserting "1.4 percent".

(b) REPEAL OF SPECIAL RULES FOR CERTAIN PRIVATE FOUNDATIONS.—Section 4940 is amended by striking subsection (e).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 5102. PRIVATE OPERATING FOUNDATION REQUIREMENTS RELATING TO OPERATION OF ART MUSEUM.

(a) IN GENERAL.—Section 4942(j) is amended by adding at the end the following new paragraph:

"(6) ORGANIZATION OPERATING ART MUSEUM.—For purposes of this section, the term 'operating foundation' shall not include an organization which operates an art museum as a substantial activity unless such museum is open during normal business hours to the public for at least 1,000 hours during the taxable year.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 5103. EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE COLLEGES AND UNIVERSITIES.

(a) IN GENERAL.—Chapter 42 is amended by adding at the end the following new subchapter:

"Subchapter H—Excise Tax Based on Investment Income of Private Colleges and Universities

"SEC. 4969. EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE COLLEGES AND UNIVERSITIES.

"(a) TAX IMPOSED.—There is hereby imposed on each applicable educational institution for the taxable year a tax equal to 1.4 percent of the net investment income of such institution for the taxable year.

"(b) APPLICABLE EDUCATIONAL INSTITUTION.—For purposes of this subchapter—

"(1) IN GENERAL.—The term 'applicable educational institution' means an eligible educational institution (as defined in section 25A(e)(3))—

"(A) which has at least 500 students during the preceding taxable year,

"(B) which is not described in the first sentence of section 511(a)(2)(B), and

"(C) the aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those assets which are used directly in carrying out the institution's exempt purpose) is at least $250,000 per student of the institution.

"(2) STUDENTS.—For purposes of paragraph (1), the number of students of an institution shall be based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis).

"(c) NET INVESTMENT INCOME.—For purposes of this section, net investment income shall be determined under rules similar to the rules of section 4940(c).

"(d) ASSETS AND NET INVESTMENT INCOME OF RELATED ORGANIZATIONS.—

"(1) IN GENERAL.—For purposes of subsections (b)(1)(C) and (c), the assets and net investment income of any related organization shall be treated as the assets and net investment income of the eligible educational institution.

"(2) RELATED ORGANIZATION.—For purposes of this subsection, the term 'related organization' means, with respect to an eligible educational institution, any organization which—

"(A) controls, or is controlled by, such institution,

"(B) is controlled by one or more persons that control such institution, or

"(C) is a supported organization (as defined in section 509(f)(3)), or an organization described in section 509(a)(3), during the taxable year with respect to such institution.".

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 42 is amended by adding at the end the following new item:

"SUBCHAPTER H—EXCISE TAX BASED ON INVESTMENT INCOME OF PRIVATE COLLEGES AND UNIVERSITIES".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 5104. EXCEPTION FROM PRIVATE FOUNDATION EXCESS BUSINESS HOLDING TAX FOR INDEPENDENTLY-OPERATED PHILANTHROPIC BUSINESS HOLDINGS.

(a) IN GENERAL.—Section 4943 is amended by adding at the end the following new subsection:

"(g) EXCEPTION FOR CERTAIN HOLDINGS LIMITED TO INDEPENDENTLY-OPERATED PHILANTHROPIC BUSINESS.—

"(1) IN GENERAL.—Subsection (a) shall not apply with respect to the holdings of a private foundation in any business enterprise which for the taxable year meets—

"(A) the ownership requirements of paragraph (2),

"(B) the all profits to charity distribution requirement of paragraph (3), and

"(C) the independent operation requirements of paragraph (4).

"(2) OWNERSHIP.—The ownership requirements of this paragraph are met if—

"(A) 100 percent of the voting stock in the business enterprise is held by the private foundation at all times during the taxable year, and

"(B) all the private foundation's ownership interests in the business enterprise were acquired not by purchase.

"(3) ALL PROFITS TO CHARITY.—

"(A) IN GENERAL.—The all profits to charity distribution requirement of this paragraph is met if the business enterprise, not later than 120 days after the close of the taxable year, distributes an amount equal to its net operating income for such taxable year to the private foundation.

"(B) NET OPERATING INCOME.—For purposes of this paragraph, the net operating income of any business enterprise for any taxable year is an amount equal to the gross income of the business enterprise for the taxable year, reduced by the sum of—

"(i) the deductions allowed by chapter 1 for the taxable year which are directly connected with the production of such income, "(ii) the tax imposed by chapter 1 on the business enterprise for the taxable year, and

"(iii) an amount for a reasonable reserve for working capital and other business needs of the business enterprise.

"(4) INDEPENDENT OPERATION.—The independent operation requirements of this paragraph are met if, at all times during the taxable year—

"(A) no substantial contributor (as defined in section 4958(c)(3)(C)) to the private foundation, or family member of such a contributor (determined under section 4958(f)(4)) is a director, officer, trustee, manager, employee, or contractor of the business enterprise (or an individual having powers or responsibilities similar to any of the foregoing),

"(B) at least a majority of the board of directors of the private foundation are not—

"(i) also directors or officers of the business enterprise, or

"(ii) members of the family (determined under section 4958(f)(4)) of a substantial contributor (as defined in section 4958(c)(3)(C)) to the private foundation, and

"(C) there is no loan outstanding from the business enterprise to a substantial contributor (as so defined) to the private foundation or a family member of such contributor (as so determined).

"(5) CERTAIN DEEMED PRIVATE FOUNDATIONS EXCLUDED.—This subsection shall not apply to—

"(A) any fund or organization treated as a private foundation for purposes of this section by reason of subsection (e) or (f),

"(B) any trust described in section 4947(a)(1) (relating to charitable trusts), and

"(C) any trust described in section 4947(a)(2) (relating to split-interest trusts).".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2017.

Subtitle C—Requirements for Organizations Exempt From Tax

SEC. 5201. 501(c)(3) ORGANIZATIONS PERMITTED TO MAKE STATEMENTS RELATING TO POLITICAL CAMPAIGN IN ORDINARY COURSE OF ACTIVITIES.

(a) IN GENERAL.—Section 501 is amended by adding at the end the following new subsection:

"(s) SPECIAL RULE RELATING TO POLITICAL CAMPAIGN STATEMENTS OF ORGANIZATIONS DESCRIBED IN SUBSECTION (c)(3).—

"(1) IN GENERAL.—For purposes of subsection (c)(3) and sections 170(c)(2), 2055, 2106, 2522, and 4955, an organization shall not fail to be treated as organized and operated exclusively for a purpose described in subsection (c)(3), nor shall it be deemed to have participated in, or intervened in any political campaign on behalf of (or in opposition to) any candidate for public office, solely because of the content of any statement which—

"(A) is made in the ordinary course of the organization's regular and customary activities in carrying out its exempt purpose, and

"(B) results in the organization incurring not more than de minimis incremental expenses.

"(2) TERMINATION.—Paragraph (1) shall not apply to taxable years beginning after December 31, 2023.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2018.

SEC. 5202. ADDITIONAL REPORTING REQUIREMENTS FOR DONOR ADVISED FUND SPONSORING ORGANIZATIONS.

(a) IN GENERAL.—Section 6033(k) is amended by striking "and" at the end of paragraph (2), by striking the period at the end of paragraph (3), and by adding at the end the following new paragraphs:

"(4) indicate the average amount of grants made from such funds during such taxable year (expressed as a percentage of the value of assets held in such funds at the beginning of such taxable year), and

"(5) indicate whether the organization has a policy with respect to donor advised funds (as so defined) for frequency and minimum level of distributions. Such organization shall include with such return a copy of any policy described in paragraph (5).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply for returns filed for taxable years beginning after December 31, 2017.

Amend the title so as to read:

A bill to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

H.R. 1, as reported by the Committee on Ways and Means, makes comprehensive reforms to the Internal Revenue Code of 1986 to provide tax relief and simplification to American families and individuals so that they can keep more of what they earn and devote less time and resources to filing their tax returns; to provide tax relief to businesses of all sizes so that they can create jobs, increase paychecks, and invest in the American economy; and to modernize the U.S. international tax system to unleash the global competitiveness of America and American businesses. H.R. 1 fulfills the reconciliation instructions included in Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018.

B. BACKGROUND AND NEED FOR LEGISLATION

H.R. 1 reflects the Committee's long-standing focus on achieving comprehensive tax reform in order to promote economic growth and job creation, to support global competiveness, and to reduce tax burdens on families and individuals. Lowering tax burdens on the middle class and creating a healthier economy will help American families, as will reforms that make the system simpler and fairer for taxpayers. Lowering the tax burden on businesses small and large and modernizing the U.S. international tax rules will promote investment and job creation and put America back in the lead pack. The Committee believes that H.R. 1 delivers a 21st century tax code that is built for growth.

C. LEGISLATIVE HISTORY

Budget resolution

On October 26, 2017, the House of Representatives approved H. Con. Res. 71, the budget resolution for fiscal year 2018. Pursuant to section 5113(b) of H. Con. Res. 71, the Committee on Ways and Means was directed to submit to the Committee on the Budget recommendations for changes in law within the jurisdiction of the Committee on Ways and Means that increase the deficit by not more than $1,500,000,000,000 for the period of fiscal years 2018 through 2027.

Committee action

Beginning November 6, 2017, the Committee on Ways and Means marked up H.R. 1, a bill to provide for reconciliation pursuant to the concurrent resolution on the budget for fiscal year 2018, and ordered the bill, as amended, favorably reported (with a quorum being present) on November 9, 2017.

Committee hearings

The Ways and Means Committee has held extensive hearings over many years focused on tax reform overall and on particular aspects of tax reform.

During the 115th Congress, the Committee held the following hearings that addressed aspects of tax reform:

- How Tax Reform Will Grow our Economy and Create Jobs (May 18, 2017)
- Increasing U.S. Competitiveness and Preventing American Jobs from Moving Overseas (May 23, 2017)
- The President's Fiscal Year 2018 Budget Proposals (May 24, 2017).

Also during the 115th Congress, the Subcommittee on Tax Policy held hearings on the following tax reform topics:

- How Tax Reform Will Help America's Small Businesses Grow and Create New Jobs (July 13, 2017)
- How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families (July 19, 2017).

In addition, the Committee and its Subcommittees held many hearings over the past several years on a wide variety of subjects relevant to comprehensive tax reform, including the following hearings:

Committee on Ways and Means

- The Global Tax Environment in 2016 and Implications for International Tax Reform (February 24, 2016)
- Reaching America's Potential: Delivering Growth and Opportunity for All Americans (February 2, 2016)
- Benefits of Permanent Tax Policy for America's Job Creators (April 8, 2014).
- Tax Reform: Tax Havens, Base Erosion, and Profit-Shifting (June 13, 2013)
- Tax Reform and Residential Real Estate (April 25, 2013)
- Tax Reform and Tax Provisions Affecting State and Local Governments (March 19, 2013)
- Tax Reform and Charitable Contributions (February 14, 2013)
- Tax Reform and the Tax Treatment of Capital Gains (September 20, 2012)
- Tax Reform and the U.S. Manufacturing Sector (July 19, 2012)
- Tax Reform and Tax-Favored Retirement Accounts (April 17, 2012)
- Treatment of Closely-Held Businesses in the Context of Tax Reform (March 7, 2012)
- Interaction of Tax and Financial Accounting on Tax Reform (February 8, 2012)
- Economic Models Available to the Joint Committee on Taxation for Analyzing Tax Reform Proposals (September 21, 2011)
- Tax Reform and Consumption-Based Tax Systems (July 26, 2011)
- Tax Reform and the Tax Treatment of Debt and Equity (July 13, 2011)

- How Business Tax Reform Can Encourage Job Creation (June 2, 2011)
- How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs (May 24, 2011)
- The Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers (May 12, 2011)
- How the Tax Code's Burdens on Individuals and Families Demonstrate the Need for Comprehensive Tax Reform (April 13, 2011)
- Fundamental Tax Reform (January 20, 2011)

Subcommittee on Tax Policy (formerly Subcommittee on Select Revenue Measures)

- Perspectives on Need for Tax Reform (May 25, 2016)
- Member Proposals for Improvements to the U.S. Tax System (May 12, 2016)
- Fundamental Tax Reform Proposals, Part II (April 13, 2016)
- Fundamental Tax Reform Proposals, Part I (March 22, 2016)
- OECD Base Erosion and Profit Shifting (BEPS) Project (December 1, 2015)
- Burden of the Estate Tax on Family Businesses and Farms (March 18, 2015)
- Dynamic Analysis of the Tax Reform Act of 2014 (July 30, 2014)
- Small Business Pass-Through Entity Tax Reform Discussion Draft (May 15, 2013)
- Financial Products Tax Reform Discussion Draft (March 20, 2013)
- How Welfare and Tax Benefits Can Discourage Work (June 27, 2012)
- Framework for Evaluating Certain Expiring Tax Provisions (June 8, 2012)
- Certain Expiring Tax Provisions (April 26, 2012)
- International Tax Reform Discussion Draft (November 17, 2011)
- Energy Tax Policy and Tax Reform (September 22, 2011)
- Tax Reform and Foreign Investment in the United States (June 23, 2011)
- Small Business and Tax Reform (March 3, 2011)

Subcommittee on Oversight

- Back to School: A Review of Tax-Exempt College and University Endowments (September 13, 2016)
- Tax-Exempt Colleges and Universities: Encouraging the Free Exchange of Ideas (March 2, 2016)
- The Rising Costs of Higher Education and Tax Policy (October 7, 2015)
- The Department of Labor's Proposed Fiduciary Rule (September 30, 2015)
- Protecting Small Businesses from IRS Abuse (February 11, 2015)

• Internal Revenue Service's Colleges and Universities Compliance Project (May 8, 2013)
• Public Charity Organizational Issues, Unrelated Business Income Tax, and the Revised Form 990 (July 25, 2012)
• Tax Exempt Organizations (May 16, 2012)

II. EXPLANATION OF THE BILL

TITLE I—TAX REFORM FOR INDIVIDUALS

A. SIMPLIFICATION AND REFORM OF RATES, STANDARD DEDUCTIONS, AND EXEMPTIONS

1. Reduction and simplification of individual income tax rates (secs. 1001 and 1005 of the bill and sec. 1 of the Code)

PRESENT LAW

In general

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular 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.

Tax rate schedules

Separate rate schedules apply based on an individual's filing status. For 2017, the regular individual income tax rate schedules are as follows:

TABLE 1.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2017 [1]

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $9,325	10% of the taxable income.
Over $9,325 but not over $37,950	$932.50 plus 15% of the excess over $9,325.
Over $37,950 but not over $91,900	$5,226.25 plus 25% of the excess over $37,950.
Over $91,900 but not over $191,650	$18,713.75 plus 28% of the excess over $91,900.
Over $191,650 but not over $416,700	$46,643.75 plus 33% of the excess over $191,650.
Over $416,700 but not over $418,400	$120,910.25 plus 35% of the excess over $416,700.
Over $418,400	$121,505.25 plus 39.6% of the excess over $418,400.
Heads of Households	
Not over $13,350	10% of the taxable income.
Over $13,350 but not over $50,800	$1,335 plus 15% of the excess over $13,350.
Over $50,800 but not over $131,200	$6,952.50 plus 25% of the excess over $50,800.
Over $131,200 but not over $212,500	$27,052.50 plus 28% of the excess over $131,200.
Over $212,500 but not over $416,700	$49,816.50 plus 33% of the excess over $212,500.
Over $416,700 but not over $444,550	$117,202.50 plus 35% of the excess over $416,700.
Over $444,550	$126,950 plus 39.6% of the excess over $444,550.
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $18,650	10% of the taxable income.
Over $18,650 but not over $75,900	$1,865 plus 15% of the excess over $18,650.
Over $75,900 but not over $153,100	$10,452.50 plus 25% of the excess over $75,900.
Over $153,100 but not over $233,350	$29,752.50 plus 28% of the excess over $153,100.
Over $233,350 but not over $416,700	$52,222.50 plus 33% of the excess over $233,350.
Over $416,700 but not over $470,700	$112,728 plus 35% of the excess over $416,700.
Over $470,700	$131,628 plus 39.6% of the excess over $470,700.

TABLE 1.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2017 [1]—Continued

If taxable income is:	Then income tax equals:
Married Individuals Filing Separate Returns	
Not over $9,325	10% of the taxable income.
Over $9,325 but not over $37,950	$932.50 plus 15% of the excess over $9,325.
Over $37,950 but not over $76,550	$5,226.25 plus 25% of the excess over $37,950.
Over $76,550 but not over $116,675	$14,876.25 plus 28% of the excess over $76,550.
Over $116,675 but not over $208,350	$26,111.25 plus 33% of the excess over $116,675.
Over $208,350 but not over $235,350	$56,364 plus 35% of the excess over $208,350.
Over $235,350	$65,814 plus 39.6% of the excess over $235,350.
Estates and Trusts	
Not over $2,550	15% of the taxable income.
Over $2,550 but not over $6,000	$382.50 plus 25% of the excess over $2,550.
Over $6,000 but not over $9,150	$1,245 plus 28% of the excess over $6,000.
Over $9,150 but not over $12,500	$2,127 plus 33% of the excess over $9,150.
Over $12,500	$3,232.50 plus 39.6% of the excess over $12,500.

[1] Rev. Proc. 2016–55, 2016–45 I.R.B. 707, sec. 3.01.

Unearned income of children

Special rules (generally referred to as the "kiddie tax") apply to the net unearned income of certain children.[1] Generally, the kiddie tax applies to a child if: (1) the child has not reached the age of 19 by the close of the taxable year, or the child is a full-time student under the age of 24, and either of the child's parents is alive at such time; (2) the child's unearned income exceeds $2,100 (for 2017); and (3) the child does not file a joint return.[2] The kiddie tax applies regardless of whether the child may be claimed as a dependent by either or both parents. For children above age 17, the kiddie tax applies only to children whose earned income does not exceed one-half of the amount of their support.

Under these rules, the net unearned income of a child (for 2017, unearned income over $2,100) is taxed at the parents' tax rates if the parents' tax rates are higher than the tax rates of the child.[3] The remainder of a child's taxable income (i.e., earned income, plus unearned income up to $2,100 (for 2017), less the child's standard deduction) is taxed at the child's rates, regardless of whether the kiddie tax applies to the child. For these purposes, unearned income is income other than wages, salaries, professional fees, other amounts received as compensation for personal services actually rendered, and distributions from qualified disability trusts.[4] In general, a child is eligible to use the preferential tax rates for qualified dividends and capital gains.[5]

The kiddie tax is calculated by computing the "allocable parental tax." This involves adding the net unearned income of the child to the parent's income and then applying the parent's tax rate. A child's "net unearned income" is the child's unearned income less the sum of (1) the minimum standard deduction allowed to dependents ($1,050 for 2017[6]), and (2) the greater of (a) such minimum

[1] Sec. 1(g). Unless otherwise stated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").
[2] Sec. 1(g)(2).
[3] Special rules apply for determining which parent's rate applies where a joint return is not filed.
[4] Sec. 1(g)(4) and sec. 911(d)(2).
[5] Sec. 1(h).
[6] Sec. 3.02 of Rev. Proc. 2016–55, *supra*.

standard deduction amount or (b) the amount of allowable itemized deductions that are directly connected with the production of the unearned income.[7]

The allocable parental tax equals the hypothetical increase in tax to the parent that results from adding the child's net unearned income to the parent's taxable income.[8] If the child has net capital gains or qualified dividends, these items are allocated to the parent's hypothetical taxable income according to the ratio of net unearned income to the child's total unearned income. If a parent has more than one child subject to the kiddie tax, the net unearned income of all children is combined, and a single kiddie tax is calculated. Each child is then allocated a proportionate share of the hypothetical increase, based upon the child's net unearned income relative to the aggregate net unearned income of all of the parent's children subject to the tax.

Generally, a child must file a separate return to report his or her income.[9] In such case, items on the parents' return are not affected by the child's income, and the total tax due from the child is the greater of:

1. The sum of (a) the tax payable by the child on the child's earned income and unearned income up to $2,100 (for 2017), plus (b) the allocable parental tax on the child's unearned income, or
2. The tax on the child's income without regard to the kiddie tax provisions.[10]

Under certain circumstances, a parent may elect to report a child's unearned income on the parent's return.[11]

Indexing tax provisions for inflation

Under present law, many parameters of the tax system are adjusted for inflation to protect taxpayers from the effects of rising prices. Most of the adjustments are based on annual changes in the level of the Consumer Price Index for all Urban Consumers ("CPI–U").[12] The CPI–U is an index that measures prices paid by typical urban consumers on a broad range of products, and is developed and published by the Department of Labor.

Among the inflation-indexed tax parameters are the following individual income tax amounts: (1) the regular income tax brackets; (2) the basic standard deduction; (3) the additional standard deduction for aged and blind; (4) the personal exemption amount; (5) the thresholds for the overall limitation on itemized deductions and the personal exemption phase-out; (6) the phase-in and phase-out thresholds of the earned income credit; (7) IRA contribution limits and deductible amounts; and (8) the saver's credit.

Capital gains rates

In general

In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10- or 15-per-

[7] Sec. 1(g)(4).
[8] Sec. 1(g)(3).
[9] Sec. 1(g)(6). See Form 8615, Tax for Certain Children Who Have Unearned Income.
[10] Sec. 1(g)(1).
[11] Sec. 1(g)(7).
[12] Sec. 1(f)(5).

cent rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15-percent and below 39.6 percent is taxed at a 15-percent rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6-percent rate is taxed at a 20-percent rate.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate.

In addition, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

Definitions

Net capital gain

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Adjusted net capital gain

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

Qualified dividend income

Adjusted net capital gain is increased by the amount of qualified dividend income.

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits. Qualified dividends generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of qualified dividend income that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

Dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities are not qualified dividend income.

28-percent rate gain

The term "28-percent rate gain" means the excess of the sum of the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not apply, over the sum of the net short-term capital loss for the taxable year and any long-term capital loss carryover to the taxable year.

Unrecaptured section 1250 gain

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

REASONS FOR CHANGE

The Committee believes that changing the individual rate structure by reducing the total number of rate brackets and the size of some rate brackets creates a simpler and fairer Federal income tax. The committee further believes that a tax system with lower rates will allow taxpayers to keep more of their earnings to spend on family needs and will contribute to economic growth.

Under present law, the tax on the unearned income of children depends on the income of the child, parents, and when applicable, siblings. The Committee intends to simplify the taxation of unearned income of children, while continuing to minimize the benefit of tax-motivated income shifting, by subjecting this unearned income to the rates applicable to trusts.

The Committee believes that the cost-of-living adjustments provided throughout the code can be improved by indexing with the chained Consumer Price Index ("C–CPI–U"), which is designed by the Bureau of Labor Statistics to be a closer approximation of a cost-of-living index than other CPI measures.

EXPLANATION OF PROVISION

Modification of rates

The provision replaces the individual income tax rate structure with a new rate structure.

TABLE 2.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE PROVISION

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $45,000	12% of the taxable income.
Over $45,000 but not over $200,000	$5,400 plus 25% of the excess over $45,000.
Over $200,000 but not over $500,000	$44,150 plus 35% of the excess over $200,000.
Over $500,000	$149,150 plus 39.6% of the excess over $500,000.
Heads of Households	
Not over $67,500	12% of the taxable income.
Over $67,500 but not over $200,000	$8,100 plus 25% of the excess over $67,500.
Over $200,000 but not over $500,000	$41,225 plus 35% of the excess over $200,000.
Over $500,000	$146,225 plus 39.6% of the excess over $500,000.
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $90,000	12% of the taxable income.
Over $90,000 but not over $260,000	$10,800 plus 25% of the excess over $90,000.
Over $260,000 but not over $1,000,000	$53,300 plus 35% of the excess over $260,000.
Over $1,000,000	$312,300 plus 39.6% of the excess over $1,000,000.
Married Individuals Filing Separate Returns	
Not over $45,000	12% of the taxable income.
Over $45,000 but not over $130,000	$5,400 plus 25% of the excess over $45,000.
Over $130,000 but not over $500,000	$26,650 plus 35% of the excess over $130,000.
Over $500,000	$156,150 plus 39.6% of the excess over $500,000.
Estates and Trusts	
Not over $2,550	12% of the taxable income.
Over $2,550 but not over $9,150	$306 plus 25% of the excess over $2,550.
Over $9,150 but not over $12,500	$1,956 plus 35% of the excess over $9,150.
Over $12,500	$3,128.50 plus 39.6% of the excess over $12,500.

The bracket thresholds are all adjusted for inflation and then rounded to the next lowest multiple of $100 in future years. Unlike present law (which uses a measure of the consumer price index for all-urban consumers), the new inflation adjustment uses the chained consumer price index for all-urban consumers.

Phaseout of benefit of the 12-percent bracket

For taxpayers with adjusted gross income in excess of $1,000,000 ($1,200,000 in the case of married taxpayers filing jointly), the benefit of the 12-percent bracket, as measured against the 39.6-percent bracket, is phased out at a rate of 6-percent for taxpayers whose AGI is in excess of these amounts. Thus, in the case of a married taxpayer filing a joint return, if AGI is in excess of $1,200,000, the benefit of $24,840 (27.6-percent of $90,000) phases out over an income range of $414,000. The phaseout thresholds are indexed for inflation.

Simplification of tax on unearned income of children

The provision simplifies the "kiddie tax" by effectively applying the rates applicable to trusts, without the 12-percent rate applicable to estates and trusts, to the net unearned income of a child to whom the provision applies. Specifically, the amount of taxable income taxed at a 12 percent rate may not exceed the amount of taxable income in excess of the net unearned income of the child. The amount of taxable income taxed at rates below 35 percent may not exceed sum of (1) the taxable income in excess of the net unearned income of the child plus (2) the amount of taxable income not in excess of the 35-percent bracket threshold applicable to a trust. The amount of taxable income taxed at rates below 39.6 percent may not exceed sum of (1) the taxable income in excess of the net unearned income of the child plus (2) the amount of taxable income not in excess of the 39.6-percent bracket threshold applicable to a trust.

The following examples illustrate the application of the provision:

Example 1.—Assume a child to whom the "kiddie tax" applies has $60,000 taxable income of which $50,000 is net unearned income, which would otherwise be treated as ordinary income, such as interest. Assume the 25-percent bracket threshold amount for the taxable year is $45,000 for an unmarried taxpayer, and the 35-percent and 39.6-percent bracket thresholds for a trust are $9,150 and $12,500 respectively.

The child's 25-percent bracket threshold is $10,000 ($60,000 less $50,000), 35-percent bracket threshold is $19,150 ($10,000 plus $9,150), and 39.6-percent bracket threshold is $22,500 ($10,000 plus $12,500). Thus, $10,000 is taxed at a 12-percent rate, $9,150 at a 25 percent rate, $3,350 at a 35-percent rate, and $37,500 at a 39.6-percent rate.

Example 2.—Assume the same facts as Example 1 except that the amount of the child's net unearned income is $20,000 (rather than $50,000).

The child's 25-percent bracket threshold is $40,000 ($60,000 less $50,000), 35-percent bracket threshold is $49,150 ($40,000 plus $9,150), and the 39.6-percent bracket threshold is $52,500 ($40,000 plus $12,500). Thus, $40,000 is taxed at a 10-percent rate, $9,150 at a 25-percent rate, $3,350 at a 35-percent rate, and $7,500 at a 39.6-percent rate.

Replacing CPI–U with chained CPI–U

The provision requires the use of the chained CPI–U ("C–CPI–U") to index tax parameters currently indexed by the CPI–U. The C–CPI–U, like the CPI–U, is a measure of the average change over time in prices paid by urban consumers. It is developed and published by the Department of Labor, but differs from the CPI–U in accounting for the ability of individuals to alter their consumption patterns in response to relative price changes. The C–CPI–U accomplishes this by allowing for consumer substitution between item categories in the market basket of consumer goods and services that make up the index, while the CPI–U only allows for modest substitution within item categories. Values that are reset for 2018, such as the bracket thresholds and standard deduction, are indexed by the C–CPI–U in taxable years beginning after December 31, 2018. Other indexed values in the code switch from CPI indexing to C–CPI–U indexing going forward in taxable years beginning after December 31, 2017.

Maximum rates on capital gains and qualified dividends

The provision generally retains the present-law maximum rates on net capital gain and qualified dividends. The breakpoints between the zero-and 15-percent rates ("15-percent breakpoint") and the 15-and 20-percent rates ("20-percent breakpoint") are the same amounts as the breakpoints under present law, except the breakpoints are indexed using the C–CPI–U in taxable years beginning after 2017. Thus, for 2018, the 15-percent breakpoint is $77,200 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $51,700 for heads of household, $2,600 for estates and trusts, and $38,600 for other unmarried individuals. The 20-percent breakpoint is $479,000 for joint returns and surviving spouses (one-half of this amount for married taxpayers filing separately), $452,400 for heads of household, $12,700 for estates and trusts, and $425,800 for other unmarried individuals.

Therefore, in the case of an individual (including an estate or trust) with adjusted net capital gain, to the extent the gain would not result in taxable income exceeding the 15-percent breakpoint is not taxed. Any adjusted net capital gain which would result in taxable income exceeding the 15-percent breakpoint but not exceeding the 20-percent breakpoint is taxed at 15 percent. The remaining adjusted net capital gain is taxed at 20 percent.

As under present law, unrecaptured section 1250 gain generally is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent.

EFFECTIVE DATE

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

2. Enhancement of standard deduction (sec. 1002 of the bill and sec. 63 of the Code)

PRESENT LAW

Under present law, an individual who does not elect to itemize deductions may reduce his adjusted gross income ("AGI") by the amount of the applicable standard deduction in arriving at his taxable income. The standard deduction is the sum of the basic standard deduction and, if applicable, the additional standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2017, the amount of the basic standard deduction is $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 and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind.[13] The amount of the standard deduction is indexed annually for inflation.

In the case of a dependent for whom a deduction for a personal exemption is allowed to another taxpayer, the standard deduction may not exceed the greater of (i) $1,050 (in 2017) or (ii) the sum of $350 (in 2017) plus the individual's earned income.

[13] For 2017, the additional amount is $1,250 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,550. An individual who qualifies as both blind and elderly is entitled to two additional standard educations, for a total additional amount (for 2017) of $2,500 or $3,100, as applicable.

REASONS FOR CHANGE

The Committee believes that consolidating the basic standard deduction, additional standard deduction, personal exemption, and other tax benefits for taxpayer and spouse into a larger standard deduction simplifies the tax code while allowing a minimum level of income to be exempt from Federal income taxation.

EXPLANATION OF PROVISION

The provision increases the standard deduction for individuals across all filing statuses. Under the provision, the amount of the standard deduction is $24,400 for married individuals filing a joint return, $18,300 for head-of-household filers, and $12,200 for all other taxpayers. The amount of the standard deduction is indexed for inflation using the chained consumer price index for all-urban consumers for taxable years beginning after December 31, 2019.[14]

The provision eliminates the additional standard deduction for the aged and the blind.

EFFECTIVE DATE

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

3. Repeal of deduction for personal exemptions (sec. 1003 of the bill and secs. 151–153 of the Code)

PRESENT LAW

Under present law, in determining taxable income, an individual reduces AGI by any personal exemption deductions and either the applicable standard deduction or his or her itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2017, the amount deductible for each personal exemption is $4,050. This amount is indexed annually for inflation. The personal exemption amount is phased out in the case of an individual with AGI in excess of $313,800 for taxpayers filing jointly, $287,650 for heads of household and $261,500 for all other filers. In addition, no personal exemption is allowed in the case of a dependent if a deduction is allowed to another taxpayer.

Withholding rules

Under present law, the amount of tax required to be withheld by employers from a taxpayer's wages is based in part on the number of withholding exemptions a taxpayer claims on his Form W–4. An employee is entitled to the following exemptions: (1) an exemption for himself, unless he allowed to be claimed as a dependent of another person; (2) an exemption to which the employee's spouse would be entitled, if that spouse does not file a Form W–4 for that taxable year claiming an exemption described in (1); (3) an exemption for each individual who is a dependent (but only if the employee's spouse has not also claimed such a withholding exemption on a Form W–4); (4) additional withholding allowances (taking into account estimated itemized deductions, estimated tax credits, and ad-

[14] Thus, the standard deduction is the same for 2018 and 2019.

ditional deductions as provided by the Secretary of the Treasury); and (5) a standard deduction allowance.

Filing requirements

Under present law, an unmarried individual is required to file a tax return for the taxable year if in that year the individual had income which equals or exceeds the exemption amount plus the standard deduction applicable to such individual (i.e., single, head of household, or surviving spouse). An individual entitled to file a joint return is required to do so unless that individual's gross income, when combined with the individual's spouse's gross income for the taxable year, is less than the sum of twice the exemption amount plus the basic standard deduction applicable to a joint return, provided that such individual and his spouse, at the close of the taxable year, had the same household as their home.

TRUSTS AND ESTATES

In lieu of the deduction for personal exemptions, an estate is allowed a deduction of $600. A trust is allowed a deduction of $100; $300 if required to distribute all its income currently; and an amount equal to the personal exemption of an individual in the case of a qualified disability trust.

REASONS FOR CHANGE

The Committee believes that consolidating the basic standard deduction, additional standard deduction, personal exemption, and other tax benefits for taxpayer and spouse into a larger standard deduction simplifies the tax code while allowing a minimum level of income to be exempt from Federal income taxation.

EXPLANATION OF PROVISION

The provision repeals the deduction for personal exemptions.

The provision modifies the requirements for those who are required to file a tax return. In the case of an individual who is not married, such individual is required to file a tax return if the taxpayer's gross income for the taxable year exceeds the applicable standard deduction. Married individuals are required to file a return if that individual's gross income, when combined with the individual's spouse's gross income, for the taxable year is more than the standard deduction applicable to a joint return, provided that: (i) such individual and his spouse, at the close of the taxable year, had the same household as their home; (ii) the individual's spouse does not make a separate return; and (iii) neither the individual nor his spouse is a dependent of another taxpayer who has income (other than earned income) in excess of $500 (indexed for inflation).

The provision repeals the enhanced deduction for qualified disability trusts.

Under the provision, the Secretary of the Treasury is to develop rules to determine the amount of tax required to be withheld by employers from a taxpayer's wages.

EFFECTIVE DATE

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

4. Maximum rate on business income of individuals (sec. 1004 of the bill and new sec. 4 of the Code)

PRESENT LAW

Individual income tax rates

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular 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 (*i.e,* single, head of household, married filing jointly, or married filing separately). For 2017, the regular individual income tax rate schedule provides rates of 10, 15, 25, 28, 33, 35, and 39.6 percent.

Under present law, no separate or different tax rate schedule applies to business income of individuals from partnerships, S corporations, or sole proprietorships.

Partnerships

In general

Partnerships generally are treated for Federal income tax purposes as pass-through entities not subject to tax at the entity level.[15] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the partnership are taken into account by the partners in computing their income tax liability (based on the partnership's method of accounting and regardless of whether the income is distributed to the partners).[16] A partner's deduction for partnership losses is limited to the partner's adjusted basis in its partnership interest.[17] Losses not allowed as a result of that limitation generally are carried forward to the next year. A partner's adjusted basis in the partnership interest generally equals the sum of (1) the partner's capital contributions to the partnership, (2) the partner's distributive share of partnership income, and (3) the partner's share of partnership liabilities, less (1) the partner's distributive share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any partnership distributions to the partner.[18] Partners generally may receive distributions of partnership property without recognition of gain or loss, subject to some exceptions.[19]

Partnerships may allocate items of income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.[20] In general, an allocation has substantial economic effect to the extent the partner to which the allocation is made receives the economic benefit or bears the economic burden of such allocation and the allocation substantially affects the dollar

[15] Sec. 701.

[16] Sec. 702(a).

[17] Sec. 704(d). In addition, passive loss and at-risk limitations limit the extent to which certain types of income can be offset by partnership deductions (sections 469 and 465). These limitations do not apply to corporate partners (except certain closely-held corporations) and may not be important to individual partners who have partner-level passive income from other investments.

[18] Sec. 705.

[19] Sec. 731. Gain or loss may nevertheless be recognized, for example, on the distribution of money or marketable securities, distributions with respect to contributed property, or in the case of disproportionate distributions (which can result in ordinary income).

[20] Sec. 704(b)(2).

amounts to be received by the partners from the partnership independent of tax consequences.[21]

Limited liability companies

State laws of every State provide for limited liability companies[22] ("LLCs"), which are neither partnerships nor corporations under applicable State law, but which are generally treated as partnerships for Federal tax purposes.[23]

Publicly traded partnerships

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.[24] For this purpose, a publicly traded partnership means any partnership if interests in the partnership are traded on an established securities market or interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof).[25]

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.[26]

S corporations

Generally

For Federal income tax purposes, an S corporation[27] generally is not subject to tax at the corporate level.[28] Items of income (including tax-exempt income), gain, loss, deduction, and credit of the S corporation are taken into account by the S corporation shareholders in computing their income tax liabilities (based on the S

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[21] Treas. Reg. sec. 1.704–1(b)(2).

[22] The first LLC statute was enacted in Wyoming in 1977. All States (and the District of Columbia) now have an LLC statute, though the tax treatment of LLCs for State tax purposes may differ.

[23] Under Treasury regulations promulgated in 1996, any domestic nonpublicly traded unincorporated entity with two or more members generally is treated as a partnership for federal income tax purposes, while any single-member domestic unincorporated entity generally is treated as disregarded for Federal income tax purposes (*i.e.*, treated as not separate from its owner). Instead of the applicable default treatment, however, an LLC may elect to betreate as a corporation for Federal income tax purposes. Treas. Reg. sec. 301.7701–3. These are known as the "check-the-box" regulations.

[24] Sec. 7704(a). The reasons for change stated by the Ways and Means Committee when the provision was enacted provide in part: "[t]he recent proliferation of publicly traded partnerships has come to the committee's attention. The growth in such partnerships has caused concern about long-term erosion of the corporate tax base." H.R. Rep. 100–391, Omnibus Reconciliation Act of 1987, October 26, 1987, p. 1065.

[25] Sec. 7704(b).

[26] Sec. 7704(c)(2). Qualifying income is defined to include interest, dividends, and gains from the disposition of a capital asset (or of property described in section 1231(b)) that is held for the production of income that is qualifying income. Sec. 7704(d). Qualifying income also includes rents from real property, gains from the sale or other disposition of real property, and income and gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas, oil, or products thereof), or the marketing of any mineral or natural resource (including fertilizer, geothermal energy, and timber), industrial source carbon dioxide, or the transportation or storage of certain fuel mixtures, alternative fuel, alcohol fuel, or biodiesel fuel. It also includes income and gains from commodities (not described in section 1221(a)(1)) or futures, options, or forward contracts with respect to such commodities (including foreign currency transactions of a commodity pool) where a principal activity of the partnership is the buying and selling of such commodities, futures, options, or forward contracts. However, the exception for partnerships with qualifying income does not apply to any partnership resembling a mutual fund (i.e., that would be described in section 851(a) if it were a domestic corporation), which includes a corporation registered under the Investment Company Act of 1940 (Pub. L. No. 76–768 (1940)) as a management company or unit investment trust (sec. 7704(c)(3)).

[27] An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

[28] Secs. 1363 and 1366.

corporation's method of accounting and regardless of whether the income is distributed to the shareholders). A shareholder's deduction for corporate losses is limited to the sum of the shareholder's adjusted basis in its S corporation stock and the indebtedness of the S corporation to such shareholder. Losses not allowed as a result of that limitation generally are carried forward to the next year. A shareholder's adjusted basis in the S corporation stock generally equals the sum of (1) the shareholder's capital contributions to the S corporation and (2) the shareholder's pro rata share of S corporation income, less (1) the shareholder's pro rata share of losses allowed as a deduction and certain nondeductible expenditures, and (2) any S corporation distributions to the shareholder.[29]

To be eligible to elect S corporation status, a corporation may not have more than 100 shareholders and may not have more than one class of stock.[30] Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders of an S corporation. A corporation may elect S corporation status only with the consent of all of its shareholders, and may terminate its election with the consent of shareholders holding more than 50 percent of the stock.[31] Although there are limitations on the types of shareholders and stock structure an S corporation may have, businesses organized as S corporations may be as large as those organized as C corporations or partnerships. Certain corporations may not elect S corporation status, including financial institutions using the reserve method of accounting for bad debts and insurance companies subject to tax under subchapter L.[32]

In general, an S corporation shareholder is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation.

S corporations that were previously C corporations

There are two principal exceptions to the general pass-through treatment of S corporations. Both are applicable only if the S corporation was previously a C corporation. The first applies when the C corporation had appreciated assets,[33] and the second applies when the C corporation had accumulated earnings and profits.[34]

[29] Sec. 1367. If any amount that would reduce the adjusted basis of a shareholder's S corporation stock exceeds the amount that would reduce that basis to zero, the excess is applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. If, after a reduction in the basis of such indebtedness, there is an event that would increase the adjusted basis of the shareholder's S corporation stock, such increase is instead first applied to restore the reduction in the basis of the shareholder's indebtedness. Sec. 1367(b)(2).

[30] Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

[31] Sec. 1362.

[32] Sec. 1361(b)(2).

[33] Sec. 1374. The period was seven years for taxable years beginning in 2009 and 2010, and five years for taxable years beginning in 2011, 2012, 2013, and 2014. If a C corporation elects to be an S corporation (or transfers assets to an S corporation in a carryover basis transaction), certain net built-in gains that are attributable to the period in which it was a C corporation, and that are recognized during the first five years in which the former C corporation is an S corporation, are subject to corporate-level tax.

[34] Sec. 1375. An S corporation with accumulated earnings and profits is subject to corporate tax on excess net passive investment income (but not in excess of its taxable income, subject to certain adjustments), if more than 25 percent of its gross receipts for the year are passive investment income. Subchapter C earnings and profits generally refers to the earnings of the corporation prior to its subchapter S election which would have been taxable as dividends if distributed to shareholders by the corporation prior to its subchapter S election. If the S corporation continues to have C corporation earnings and profits and has gross receipts more than 25

Sole proprietorships

Unlike a C corporation, partnership, or S corporation, a business conducted as a sole proprietorship is not treated as an entity distinct from its owner for Federal income tax purposes.[35] Rather, the business owner is taxed directly on business income, and files Schedule C (sole proprietorships generally), Schedule E (rental real estate and royalties), or Schedule F (farms) with his or her individual tax return. Furthermore, transfer of a sole proprietorship is treated as a transfer of each individual asset of the business. Nonetheless, a sole proprietorship is treated as an entity separate from its owner for employment tax purposes,[36] for certain excise taxes,[37] and certain information reporting requirements.[38]

REASONS FOR CHANGE

The Committee believes that a reduction in the corporate income tax rate to 20 percent provided by the bill does not completely address the income tax rate on business income. Many businesses are conducted in the form of passthrough entities, namely partnerships and S corporations. Further, businesses are frequently conducted as sole proprietorships, rather than through a legal entity that is treated for tax purposes as separate from the individual who owns the business. The income of businesses conducted in passthrough form or in sole proprietorship form is subject to tax in the hands of their individual owners at the income tax rates of individuals. To treat corporate and noncorporate business income more similarly under the income tax, the bill provides a maximum rate of 25 percent on qualified business income of individuals.

EXPLANATION OF PROVISION

Qualified business income of an individual from a partnership, S corporation, or sole proprietorship is subject to Federal income tax at a rate no higher than 25 percent. Qualified business income means, generally, all net business income from a passive business activity plus the capital percentage of net business income from an active business activity, reduced by carryover business losses and by certain net business losses from the current year, as determined under the provision.

Determination of rate

25-percent rate

The provision provides that an individual's tax is reduced to reflect a maximum rate of 25 percent on qualified business income.

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percent of which are passive investment income in each year for three consecutive years, the S corporation election is automatically terminated. Sec. 1362(d)(3). Further, while an S corporation shareholder generally is not subject to tax on corporate distributions unless the distributions exceed the shareholder's basis in the stock of the corporation, distributions from an S corporation that was formerly a C corporation generally are taxed to shareholders as dividends to the extent of the S corporation's accumulated earnings and profits. Sec. 1368.

[35] A single-member unincorporated entity is disregarded for Federal income tax purposes, unless its owner elects to be treated as a C corporation. Treas. Reg. sec. 301.7701–3(b)(1)(ii). Sole proprietorships often are conducted through legal entities for nontax reasons. While sole proprietorships generally may have no more than one owner, a married couple that files a joint return and jointly owns and operates a business may elect to have that business treated as a sole proprietorship under section 761(f).

[36] Treas. Reg. sec. 301.7701–2(c)(2)(iv).

[37] Treas. Reg. sec. 301.7701–2(c)(2)(v).

[38] Treas. Reg. sec. 301.7701–2(c)(2)(vi).

Qualified business income includes the capital percentage, generally 30 percent, of net business income. The percentage differs in the case of specified service activities or in the case of a taxpayer election to prove out a different percentage.

Taxable income (reduced by net capital gain) that exceeds the maximum dollar amount for the 25-percent rate bracket applicable to the taxpayer, and that exceeds qualified business income, is subject to tax in the next higher brackets.

The provision provides that a 25-percent tax rate applies generally to dividends received from a real estate investment trust (other than any portion that is a capital gain dividend or a qualified dividend), and applies generally to dividends that are includable in gross income from certain cooperatives.

Nine-percent rate

A special rule provides a reduced tax rate of 11, 10, or nine percent in the case of an individual's qualified active business income below an indexed threshold of $75,000 (in the case of a joint return or a surviving spouse) (the "nine-percent bracket threshold amount"). The indexed $75,000 threshold is three quarters of that amount for individuals filing as head of household and half that amount for other individuals. The reduced rate is not available to estates and trusts.

The reduced rate is phased in. The reduced rate is 11 percent (that is, one percentage point below the 12 percent rate) for taxable years beginning in 2018 and 2019, and is 10 percent (that is, two percentage points below the 12 percent rate) for taxable years beginning in 2020 and 2021. For taxable years beginning in 2022 and thereafter the reduced rate is nine percent (that is, three percentage points below the 12 percent rate).

The reduced tax rate applies to the least of three amounts, the taxpayer's: (1) qualified active business income, (2) taxable income reduced by net capital gain, or (3) nine-percent bracket threshold amount (described above). Qualified active business income for a taxable year means the excess of the taxpayer's net business income from any active business activity over his or her net business loss from any active business activity. An active business activity is an activity that involves the conduct of any trade or business and that is not a passive activity for purposes of the passive loss rules of section 469 determined without regard to paragraphs (2) and (6)(B) of section 469(c) (that is, generally, the taxpayer materially participates in the trade or business activity). Qualified active business income includes income from any trade or business activity, including service businesses. No capital percentage limitation applies in determining qualified active business income.

A phaseout applies to the amount subject to the 11-, 10-, or nine-percent rate. The amount taxed at one of these rates is reduced by the excess of taxable income over an indexed applicable threshold amount, $150,000 in the case of married individuals filing jointly. The applicable threshold amount is three quarters of that amount for individuals filing as head of household and half that amount for other individuals.

For example, assume that in 2022, an individual (married filing jointly) has $70,000 of qualified active business income and $40,000 of other income, resulting in taxable income of $110,000. The

$70,000 of qualified active business income is subject to tax at nine percent. Alternatively, assume that in 2022, another individual has $160,000 of qualified active business income and $10,000 of other income resulting in taxable income of $170,000. The excess of the taxpayer's $170,000 taxable income over the $150,000 applicable threshold amount is $20,000. Taking into account the phaseout, this $20,000 amount reduces the $75,000 amount that, absent the phaseout, would be subject to the nine-percent rate, reversing the benefit of the nine-percent rate for $20,000 of the taxpayer's qualified active business income. The effect is that $55,000 is subject to the nine percent rate.

Qualified business income

Qualified business income is defined as the sum of 100 percent of any net business income derived from any passive business activity plus the capital percentage of net business income derived from any active business activity, reduced by the sum of 100 percent of any net business loss derived from any passive business activity, 30 percent (except as otherwise provided under rules for determining the capital percentage, below) of any net business loss derived from any active business activity, and any carryover business loss determined for the preceding taxable year. Qualified business income does not include income from a business activity that exceeds these percentages.

Net business income or loss

To determine qualified business income requires a calculation of net business income or loss from each of an individual's passive business activities and active business activities. Net business income or loss is determined at the activity level, that is, separately for each business activity.

Net business income is determined by appropriately netting items of income, gain, deduction and loss with respect to the business activity. The determination takes into account these amounts only to the extent the amount affects the determination of taxable income for the year. For example, if in a taxable year, a business activity has 100 of ordinary income from inventory sales, and makes an expenditure of 25 that is required to be capitalized and amortized over 5 years under applicable tax rules, the net business income is 100 minus 5 (current-year ordinary amortization deduction), or 95. The net business income is not reduced by the entire amount of the capital expenditure, only by the amount deductible in determining taxable income for the year.

Net business income or loss includes the amounts received by the individual taxpayer as wages, director's fees, guaranteed payments and amounts received from a partnership other than in the individual's capacity as a partner, that are properly attributable to a business activity. These amounts are taken into account as an item of income with respect to the business activity. For example, if an individual shareholder of an S corporation engaged in a business activity is paid wages or director's fees by the S corporation, the amount of wages or director's fees is added in determining net business or loss with respect to the business activity. This rule is intended to ensure that the amount eligible for the 25-percent tax rate is not erroneously reduced because of compensation for services or other specified amounts that are paid separately (or treated as separate) from the individual's distributive share of passthrough income.

Net business income or loss does not include specified investment-related income, deductions, or loss. Specifically, net business income does not include (1) any item taken into account in determining net long-term capital gain or net long-term capital loss, (2) dividends, income equivalent to a dividend, or payments in lieu of dividends, (3) interest income and income equivalent to interest, other than that which is properly allocable to a trade or business, (4) the excess of gain over loss from commodities transactions, other than those entered into in the normal course of the trade or business or with respect to stock in trade or property held primarily for sale to customers in the ordinary course of the trade or business, property used in the trade or business, or supplies regularly used or consumed in the trade or business, (5) the excess of foreign currency gains over foreign currency losses from section 988 transactions, other than transactions directly related to the business needs of the business activity, (6) net income from notional principal contracts, other than clearly identified hedging transactions that are treated as ordinary (i.e., not treated as capital assets), and (7) any amount received from an annuity that is not used in the trade or business of the business activity. Net business income does not include any item of deduction or loss properly allocable to such income.

Carryover business loss

The carryover business loss from the preceding taxable year reduces qualified business income in the taxable year. The carryover business loss is the excess of (1) the sum of 100 percent of any net business loss derived from any passive business activity, 30 percent (except as otherwise provided under rules for determining the capital percentage, below) of any net business loss derived from any active business activity, and any carryover business loss determined for the preceding taxable year, over (2) the sum of 100 percent of any net business income derived from any passive business activity plus the capital percentage of net business income derived from any active business activity. There is no time limit on carryover business losses. For example, an individual has two business activities that give rise to a net business loss of 3 and 4, respectively, in year one, giving rise to a carryover business loss of 7 in year two. If in year two the two business activities each give rise to net business income of 2, a carryover business loss of 3 is carried to year three (that is, <7> − (2 + 2) = <3>).

Passive business activity and active business activity

A business activity means an activity that involves the conduct of any trade or business. A taxpayer's activities include those conducted through partnerships, S corporations, and sole proprietorships. An activity has the same meaning as under the present-law passive loss rules (section 469). As provided in regulations under those rules, a taxpayer may use any reasonable method of applying the relevant facts and circumstances in grouping activities together or as separate activities (through rental activities generally may not be grouped with other activities unless together they constitute an appropriate economic unit, and grouping real property rentals with personal property rentals is not permitted). It is intended that the activity grouping the taxpayer has selected under the passive loss rules is required to be used for purposes of the passthrough rate rules. For example, an individual taxpayer has an interest in a bakery and a movie theater in Baltimore, and a bakery and a movie theatre in Philadelphia. For purposes of the passive loss rules, the taxpayer has grouped them as two activities, a bakery activity and a movie theatre activity. The taxpayer must group them the same way, that is as two activities, a bakery activity and a movie theatre activity, for purposes of rules of this provision.

Regulatory authority is provided to require or permit grouping as one or as multiple activities in particular circumstances, in the case of specified services activities that would be treated as a single employer under broad related party rules of present law.

A passive business activity generally has the same meaning as a passive activity under the present-law passive loss rules. However, for this purpose, a passive business activity is not defined to exclude a working interest in any oil or gas property that the taxpayer holds directly or through an entity that does not limit the taxpayer's liability. Rather, whether the taxpayer materially participates in the activity is relevant. Further, for this purpose, a passive business activity does not include an activity in connection with a trade or business or in connection with the production of income.

An active business activity is an activity that involves the conduct of any trade or business and that is not a passive activity. For example, if an individual has a partnership interest in a manufacturing business and materially participates in the manufacturing business, it is considered an active business activity of the individual.

Capital percentage

The capital percentage is the percentage of net business income from an active business activity that is included in qualified business income subject to Federal income tax at a rate no higher than 25 percent.

In general, the capital percentage is 30 percent, except as provided in the case of application of an increased percentage for capital-intensive business activities, in the case of specified service activities, and in the case of application of the rule for capital-intensive specified service activities.

The capital percentage is reduced if the portion of net business income represented by the sum of wages, director's fees, guaranteed payments and amounts received from a partnership other than in the individual's capacity as a partner, that are properly attributable to a business activity exceeds the difference between 100 percent and the capital percentage. For example, if net business income from an individual's active business activity conducted through an S corporation is 100, including 75 of wages that the S corporation pays the individual, the otherwise applicable capital percentage is reduced from 30 percent to 25 percent.

Increased percentage for capital-intensive business activities.—A taxpayer may elect the application of an increased percentage with respect to any active business activity other than a specified service activity (described below). The election applies for the taxable year it is made and each of the next four taxable years. The election is to be made no later than the due date (including extensions) of the return for the taxable year made, and is irrevocable. The percentage under the election is the applicable percentage (described below) for the five taxable years of the election.

Specified service activities.—In the case of an active business activity that is a specified service activity, generally the capital percentage is 0 and the percentage of any net business loss from the specified service activity that is taken into account as qualified business income is 0 percent.

A specified service activity means any trade or business activity involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees, or investing, trading, or dealing in securities, partnership interests, or commodities. For this purpose a security and a commodity have the meanings provided in the rules for the mark-to-market accounting method for dealers in securities (sections 475(c)(2) and 475(e)(2), respectively).

Capital-intensive specified service activities.—A taxpayer may elect the application of an exception with respect to any active business activity that is specified service activity, provided the applicable percentage (described below) for the taxable year is at least 10 percent. If the election is validly made, the capital percentage and the percentage of net business loss with respect to the activity are not 0 percent, but rather, the applicable percentage for the taxable year.

Calculation of applicable percentage.—The applicable percentage is the percentage applied in lieu of the capital percentage in the case of either of the foregoing elections. The applicable percentage (not the capital percentage) then determines the portion of the net business income or loss from the activity for the taxable year that is taken into account in determining qualified business income subject to Federal income tax at a rate no higher than 25 percent.

The applicable percentage is determined by dividing (1) the specified return on capital for the activity for the taxable year, by (2) the taxpayer's net business income derived from that activity for that taxable year. The specified return on capital for any active business activity is determined by multiplying a deemed rate of return, the short-term AFR plus 7 percentage points, times the asset balance for the activity for the taxable year, and reducing the product by interest expense deducted with respect to the activity for the taxable year. The asset balance for this purpose is the adjusted basis of property used in connection with the activity as of the end of the taxable year, but without taking account of basis adjustments for bonus depreciation under section 168(k) or expensing under section 179. In the case of an active business activity conducted through a partnership or S corporation, the taxpayer takes into account his distributive share of the asset balance of the partnership's or S corporation's property used in connection with the activity. Regulatory authority is provided to ensure that in determining asset balance, no amount is taken into account for more than one activity.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2017. A transition rule provides that for fiscal year taxpayers whose taxable year includes December 31, 2017, a proportional benefit of the reduced rate under the provision is allowed for the period beginning January 1, 2018, and ending on the day before the beginning of the taxable year beginning after December 31, 2017.

B. Simplification and Reform of Family and Individual Tax Credits

1. Enhancement of child tax credit and new family tax credit (sec. 1101 of the bill and sec. 24 of the Code)

PRESENT 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. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("AGI") over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against both the regular tax and the alternative minimum tax ("AMT"). To the extent the child credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit[39] (the "additional child tax credit") equal to 15 percent of earned income in excess of $3,000 (the "earned income" formula).

Families with three or more children may determine the additional child tax credit using the "alternative formula," if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's earned income credit ("EIC").

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. At the taxpayer's election, combat pay may be treated as earned income for these purposes. Unlike the EIC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employ-

[39] The refundable credit may not exceed the maximum credit per child of $1,000.

ment income, and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

Any credit or refund allowed or made to an individual under this provision (including to any resident of a U.S. possession) is not taken into account as income and is not be taken into account as resources for the month of receipt and the following two months for purposes of determining eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

REASONS FOR CHANGE

The Committee believes that it is important to provide an increased tax benefit for families raising children, as well as to ensure that all members of a household are accounted for in determining families' ability to pay income tax. The Committee believes that an expanded child tax credit and a new family tax credit are an equitable means of achieving this goal.

EXPLANATION OF PROVISION

The provision expands the child tax credit into a new family tax credit. The family credit consists of a $1,600 credit per qualifying child under the age of 17, and a $300 credit for each of the taxpayer (both spouses in the case of married taxpayers filing a joint return) and each dependent of the taxpayer who is not a qualifying child under age 17.

The provision generally retains the present-law definition of dependent. However, under the provision, a qualifying child is eligible for the $1,600 credit only if such child is a citizen or national of the United States.

The family credit phases out at AGI of $230,000 for married taxpayers filing joint returns and $115,000 for other individuals. The credit is refundable under rules similar to the present law additional child tax credit. That is, to the extent the credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit equal to 15 percent of earned income in excess of $3,000.[40] The refundable credit is limited to $1,000 times the number of qualifying children under the age of 17 claimed on the return. This $1,000 per child dollar limitation is indexed for inflation, with a base year of 2017, rounding up to the nearest $100. Accordingly, in 2018 the limitation will be $1,100.

The provision requires that the taxpayer include the name and taxpayer identification number of each qualifying child and dependent on the tax return for each taxable year.

The $300 credit for the taxpayer, spouse, and non-child dependents of the taxpayer expires for taxable years beginning after December 31, 2022.

[40] The alternate formula described in the present law section applies to the refundable portion of the family credit as well.

EFFECTIVE DATE

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

2. Repeal of credit for the elderly and permanently disabled (sec. 1102(a) of the bill and sec. 22 of the Code)

PRESENT LAW

Certain taxpayers who are over the age of 65 or retired on account of permanent and total disability may claim a nonrefundable credit. The maximum credit is 15 percent of $5,000 for a return where one individual qualifies and $7,500 on a joint return where both spouses qualify.[41] Thus, the maximum credit amounts are $750 and $1,125, respectively.

The credit base is reduced by one half of the amount by which the taxpayer's adjusted gross income exceeds $7,500 if the taxpayer is unmarried, $10,000 if the taxpayer is married and files a joint return, or $5,000 if the taxpayer is married and files a separate return.[42] Thus, the credit base is phased down to zero when adjusted gross income exceeds $17,500 for an unmarried person, $20,000 for a married couple filing a joint return where only one spouse qualifies for the credit, $25,000 for a joint return where both spouses qualify, and $12,500 for a married person filing a separate return.

Additionally, the credit base is reduced by certain items of income otherwise exempt from tax: (1) benefits under Title II of the Social Security Act; (2) retirement benefits under the Railroad Retirement Act of 1974; (3) disability benefits paid by the Veterans Administration, except for benefits payable on account of personal injuries or sickness resulting from active service in the Armed Forces; and (4) pensions, annuities, and disability benefits exempted from tax by any provision not in the Code.[43]

To qualify for the credit, a taxpayer must, at the end of the taxable year, be at least 65 years old or retired on account of permanent and total disability.[44] Permanent and total disability exists if, at the time of retirement, the taxpayer was "unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.[45]

REASONS FOR CHANGE

The Committee recognizes that, because the parameters of the credit for the elderly and permanently disabled are not indexed for inflation, under present law virtually no taxpayers benefit from the credit. Accordingly, repealing the credit makes the system simpler by reducing outdated and unnecessary provisions in the Code and in IRS forms and publications.

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[41] Sec. 22(a).
[42] Sec. 22(d).
[43] Sec. 22(c)(3).
[44] Sec. 22(b).
[45] Sec. 22(e)(3).

EXPLANATION OF PROVISION

The provision repeals the credit for the elderly and permanently disabled.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

3. Termination of credit for interest on certain home mortgages (sec. 1102(b) of the bill and sec. 25 of the Code)

PRESENT LAW

Qualified governmental units can elect to exchange all or a portion of their qualified mortgage bond authority for authority to issue mortgage credit certificates ("MCCs").[46] MCCs entitle homebuyers to a nonrefundable income tax credit for a specified percentage of interest paid on mortgage loans on their principal residences. The tax credit provided by the MCC may be carried forward three years. Once issued, an MCC generally remains in effect as long as the residence being financed is the certificate-recipient's principal residence. MCCs generally are subject to the same eligibility and targeted area requirements as qualified mortgage bonds.[47]

REASONS FOR CHANGE

As the bill repeals the authority to issue qualified private activity bonds,[48] including qualified mortgage bonds, the Committee believes it is an appropriate conforming change to also terminate the related mortgage credit certificate program.

EXPLANATION OF PROVISION

No credit is allowed with respect to any MCC issued after December 31, 2017.

EFFECTIVE DATE

The provision applies to taxable years ending after December 31, 2017. Credits continue for interest paid on mortgage loans on principal residences for which MCCs have been issued on or before December 31, 2017.

4. Repeal of credit for plug-in electric drive motor vehicles (sec. 1102(c) of the bill and sec. 30D of the Code)

PRESENT LAW

A credit is available for new four-wheeled vehicles (excluding low speed vehicles and vehicles weighing 14,000 pounds or more) propelled by a battery with at least 4 kilowatt-hours of electricity that can be charged from an external source.[49] The base credit is $2,500 plus $417 for each kilowatt-hour of additional battery capacity in excess of 4 kilowatt-hours (for a maximum credit of $7,500). Quali-

[46] Sec. 25.
[47] Sec. 143.
[48] Sec. 3601 of the bill, infra.
[49] Sec. 30D.

fied vehicles are subject to a 200,000 vehicle-permanufacturer limitation. Once the limitation has been reached the credit is phased down over four calendar quarters.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the credit for plug-in electric drive motor vehicles, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals the credit for plug-in electric drive motor vehicles.

EFFECTIVE DATE

The provision is effective for vehicles placed in service in taxable years beginning after December 31, 2017.

5. Modification of taxpayer identification number requirements for the child tax credit, earned income credit, and american opportunity credit (sec. 1103 of the bill and secs. 24, 25A and 32 of the Code)

PRESENT LAW

Earned income credit

Low and moderate-income taxpayers may be eligible for the refundable earned income credit ("EIC"). Eligibility for the EIC is based on the taxpayer's earned income, adjusted gross income, investment income, filing status, and work status in the United States. The amount of the EIC is based on the presence and number of qualifying children in the worker's family, as well as on adjusted gross income and earned income.

The earned income credit generally equals a specified percentage of earned income[50] up to a maximum dollar amount. The maximum amount applies over a certain income range and then diminishes to zero over a specified phase-out range. For taxpayers with earned income (or adjusted gross income ("AGI"), if greater) in excess of the beginning of the phase-out range, the maximum EIC amount is reduced by the phase-out rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phase-out range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phase-out range, no credit is allowed.

An individual is not eligible for the EIC if the aggregate amount of disqualified income of the taxpayer for the taxable year exceeds $3,450 (for 2017). This threshold is indexed for inflation. Disqualified income is the sum of: (1) interest (taxable and tax-exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4)

[50] Earned income is defined as (1) wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income, plus (2) the amount of the individual's net self-employment earnings.

capital gains net income; and (5) net passive income (if greater than zero) that is not self-employment income.

The EIC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

Child tax credit[51]

An individual may claim a tax credit of $1,000 for each qualifying child under the age of 17. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The aggregate amount of allowable child credits is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable aggregate child tax credit ("CTC") amount is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income ("modified AGI") over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income[52] earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The child tax credit is allowable against both the regular tax and the alternative minimum tax ("AMT"). To the extent the credit exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the "additional child tax credit") equal to 15 percent of earned income in excess of a threshold dollar amount of $3,000 (the "earned income" formula).

Families with three or more qualifying children may determine the additional child tax credit using the "alternative formula" if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer's Social Security taxes exceed the taxpayer's EIC.

As with the EIC, earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EIC, the additional child tax credit is based on earned income only to the extent it is included in computing taxable income. For example, some ministers' parsonage allowances are considered self-employment income and thus are considered earned income for purposes of computing the EIC, but the allowances are excluded from gross income for individual income tax purposes and thus are not considered earned income for purposes of the additional child tax credit.

American Opportunity credit[53]

The American Opportunity credit provides individuals with a tax credit of up to $2,500 per eligible student per year for qualified tuition and related expenses (including course materials) paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The credit rate is 100 percent on the first $2,000 of qualified tuition and related expenses, and 25

[51] See description of sec. 1101 of the bill for the provision's modifications to the child tax credit.

[52] Sec. 911.

[53] See description of sec. 1201 of the bill for the provision's modifications to the American Opportunity credit.

percent on the next $2,000 of qualified tuition and related expenses.

The American Opportunity credit is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return). The credit may be claimed against a taxpayer's AMT liability.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable. A refundable credit is a credit which, if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

No credit is allowed to a taxpayer who fails to include the taxpayer identification number of the student to whom the qualified tuition and related expenses relate.

Taxpayer identification number requirements

Any individual filing a U.S. tax return is required to state his or her taxpayer identification number on such return. Generally, a taxpayer identification number is the individual's Social Security number ("SSN").[54] However, in the case of an individual who is not eligible to be issued an SSN, but who has a tax filing obligation, the Internal Revenue Service ("IRS") issues an individual taxpayer identification number ("ITIN") for use in connection with the individual's tax filing requirements.[55] An individual who is eligible to receive an SSN may not obtain an ITIN for purposes of his or her tax filing obligations.[56] An ITIN does not provide eligibility to work in the United States or claim Social Security benefits.

Examples of individuals who are not eligible for SSNs, but potentially need ITINs in order to file U.S. returns include a nonresident alien filing a claim for a reduced withholding rate under a U.S. income tax treaty, a nonresident alien required to file a U.S. tax return,[57] an individual who is a U.S. resident alien under the substantial presence test and who therefore must file a U.S. tax return,[58] a dependent or spouse of the prior two categories of individuals, or a dependent or spouse of a nonresident alien visa holder.

An individual is ineligible for the EIC (but not the child tax credit) if he or she does not include a valid SSN and the qualifying child's valid SSN (and, if married, the spouse's SSN) on his or her tax return. For these purposes, the Code defines an SSN as a Social Security number issued to an individual, other than an SSN issued to an individual solely for the purpose of applying for or receiving federally funded benefits.[59] If an individual fails to provide a correct taxpayer identification number, such omission will be treated as a mathematical or clerical error by the IRS.

A taxpayer who resides with a qualifying child may not claim the EIC with respect to the qualifying child if such child does not have a valid SSN. The taxpayer also is ineligible for the EIC for workers without children because he or she resides with a qualifying child.

[54] Sec. 6109(a).

[55] Treas. Reg. Sec. 301.6109–1(d)(3)(i).

[56] Treas. Reg. Sec. 301.6109–1(d)(3)(ii).

[57] For instance, in the case of an individual that has income which is effectively connected with a United States trade or business, such as the performance of personal services in the United States.

[58] Such an individual would have a filing requirement without regard to whether the individual is lawfully present or has work authorization.

[59] Sec. 205(c)(2)(B)(i)(II) (and that portion of sec. 205(c)(2)(B)(i)(III) relating to it) of the Social Security Act.

However, if a taxpayer has two or more qualifying children, some of whom do not have a valid SSN, the taxpayer may claim the EIC based on the number of qualifying children for whom there are valid SSNs.

REASONS FOR CHANGE

The Committee believes that it is important to ensure that refundable and other credits are not being claimed fraudulently. The Committee believes that requiring Social Security numbers as the identifying number for taxpayers and children will substantially lower the overpayment rate on these credits.

EXPLANATION OF PROVISION

Under the provision, any qualifying child claimed by the taxpayer on the tax return must use, as that child's identifying number, a Social Security number that is valid for employment in the United States in order to be eligible for the CTC. Under the provision, if a child's identifying number was other than a Social Security number (such as an ITIN), the taxpayer would be eligible to receive the $300 credit for dependents other than qualifying children, assuming such child otherwise qualified as a dependent of the taxpayer.[60]

Additionally, under the provision, taxpayers who use as their taxpayer identification number a Social Security number issued for non-work reasons, such as for purposes of receiving Federal benefits or for any other reason, are not eligible for the EIC.

Lastly, under the provision, in order to claim the American Opportunity credit, the identification number provided with respect to the student to whom the tuition and related expenses relate must be a Social Security number.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

6. Procedures to reduce improper claims of earned income credit (sec. 1104 of the bill and new secs. 32(c)(2)(B)(vii) and 6011(i) of the Code)

PRESENT LAW

Earned income credit

Low-and moderate-income workers may be eligible for the refundable earned income credit ("EIC"). Eligibility for the EIC is based on earned income, adjusted gross income ("AGI"), investment income, filing status, number of children, and immigration and work status in the United States. The maximum amount of the EIC applies over a certain income range and then diminishes to zero over a specified phaseout range. The EIC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

[60] See description of sec. 1101 of the bill.

The EIC generally equals a specified percentage of earned income up to a maximum dollar amount. Earned income is the sum of employee compensation includible in gross income (generally the amount reported in Box 1 of Form W–2, Wage and Tax Statement, discussed below) plus net earnings from self-employment determined with regard to the deduction for one-half of self-employment taxes.[61] Special rules apply in computing earned income for purposes of the EIC.[62] Net earnings from self-employment generally includes the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business that are allowed under the self-employment tax rules, plus the individual's distributive share of income or loss from any trade or business of a partnership in which the individual is a partner.[63]

Employment taxes and quarterly reporting by employers

Employment taxes include employer and employee taxes on employee wages under the Federal Insurance Contributions Act ("FICA") and income taxes required to be withheld by employers from employee wages ("income tax withholding").[64] Income tax withholding rates vary depending on the amount of wages paid, the length of the payroll period, and the number of withholding allowances claimed by the employee. Employers are required also to withhold the employee share of FICA tax from employee wages. For these purposes, wages is defined broadly to include all remuneration, subject to exceptions specifically provided in the relevant statutory provisions.

Employers generally submit quarterly reports to IRS on Form 941, Employer's Quarterly Federal Tax Return, showing the number of employees to whom wages were paid during the quarter, the total wages paid to employees, total FICA taxes (employer and employee) on the wages, and total income tax withheld from the wages.[65] In addition, by January 31 after the end of a calendar year, an employer must provide each employee with Form W–2, Wage and Tax Statement, showing the total wages paid to the employee during the calendar year and certain other information.[66] The information contained on each employee's W–2 is also provided to the IRS, accompanied by Form W–3, Transmittal of Wage and Tax Statements, showing the total number of Forms W–2 and aggregate information for all employees, such as aggregate wages reported on Forms W–2. IRS then compares the W–3 wage totals to the Form 941 (or Form 944) wage totals.

[61] Sec. 32(c)(2)(A).

[62] Sec. 32(c)(2)(B).

[63] Sec. 1402(a); Chief Counsel Advice 200022051.

[64] Secs. 3101–3128 (FICA) and 3401–3404 (income tax withholding). Employment taxes also include taxes under the Railroad Retirement Act ("RRTA"), sections 3201–3241, and tax under the Federal Unemployment Taxes Act ("FUTA"), sections 3301–3311. Sections 3501–3510 provide additional employment tax rules.

[65] Treas. Secs. 31.6011(a)–1(a)(1), 31.6011(a)–4(a)(1), 31.6011(a)–1(a)(5). If the total amount of FICA taxes and withheld income tax for a year is $1,000 or less, instead of filing Form 941 for each quarter, the employer is permitted file annually on Form 944, Employer's Annual Federal Tax Return. Separate forms and filing requirement apply with respect to RRTA and FUTA taxes.

[66] Sec. 6051(a). Employees are required to include a copy of Form W–2 when filing their income tax returns.

REASONS FOR CHANGE

The Committee recognizes that overclaims and overpayments are prevalent in the EIC program. The Committee further recognizes that the overwhelming majority of individuals making overclaims were not eligible for the credit. The Committee believes that these overclaims and overpayments can be significantly reduced by making it clear that taxpayers are required to claim all allowable deductions in determining earned income and by providing the IRS additional quarterly wage information on every taxpayer-employee such that the IRS will be able to verify reported income before any refundable EIC payment is made.

EXPLANATION OF PROVISION

Modification of the definition of "earned income"

The provision clarifies that a taxpayer is required to claim all allowable deductions in computing net earnings from self-employment for EIC purposes.

Quarterly reporting of wages by employers

The provision modifies employer reporting requirements associated with the deduction and withholding of certain employment taxes on wages. Under the provision, employers must report, along with the aggregate wages paid and employment taxes collected on Form 941 or Form 944, the name and address of each employee and the amount of reportable wages received by each of those employees.

EFFECTIVE DATE

Modification of the definition of "earned income"

The provision applies to taxable years ending after the date of enactment.

Quarterly reporting of wages by employers

The provision applies to taxable years ending after the date of enactment, subject to the authority of the Secretary to delay for such period as the Secretary determines to be reasonable to allow adequate time to modify systems to permit compliance with the additional reporting requirements.

7. Certain income disallowed for purposes of the earned income tax credit (sec. 1105 of the bill, new secs. 32(n) and 32(c)(2)(C) of the Code, and secs. 6051, 6052, 6041(a), and 6050(w) of the Code)

PRESENT LAW

Earned income credit

Low-and moderate-income workers may be eligible for the refundable earned income credit ("EIC"). Eligibility for the EIC is based on earned income, adjusted gross income ("AGI"), investment income, filing status, number of children, and immigration and work status in the United States. The maximum amount of the EIC applies over a certain income range and then diminishes to zero over a specified phaseout range. The EIC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's

Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

The EIC generally equals a specified percentage of earned income up to a maximum dollar amount. Earned income is the sum of employee compensation includible in gross income plus net earnings from self-employment determined with regard to the deduction for one-half of self-employment taxes.[67] Special rules apply in computing earned income for purposes of the EIC.[68]

Information reporting

Present law imposes a variety of information reporting requirements on participants in certain transactions.[69] These requirements are intended to assist taxpayers in preparing their income tax returns and to help the Internal Revenue Service ("IRS") determine whether such returns are correct and complete.

The primary provision governing information reporting by payors requires an information return by every person engaged in a trade or business who makes payments aggregating $600 or more in any taxable year to a single payee in the course of the payor's trade or business.[70] Payments to corporations generally are excepted from this requirement. Payments subject to reporting include fixed or determinable income or compensation, but do not include payments for goods or certain enumerated types of payments that are subject to other specific reporting requirements.[71] Detailed rules are provided for the reporting of various types of investment income, including interest, dividends, and gross proceeds from brokered transactions (such as a sale of stock) paid to U.S. persons.[72]

Special information reporting requirements exist for employers required to deduct and withhold tax from employees' income.[73] In addition, any service recipient engaged in a trade or business and paying for services is required to make a return according to regulations when the aggregate of payments is $600 or more.[74]

There are also information reporting requirements for merchant acquiring entities and third party settlement organizations with respect to payments made in settlement of payment card transactions and third party payment network transactions occurring in that calendar year.[75]

The payor of amounts described above is required to provide the recipient of the payment with an annual statement showing the aggregate payments made and contact information for the payor.[76] The statement must be supplied to taxpayers by the payors by January 31 of the following calendar year.[7] Payors generally must file

[67] Sec. 32(c)(2)(A).
[68] Sec. 32(c)(2)(B).
[69] Sec. 6031 through 6060.
[70] The information return generally is submitted electronically as a Form-1099 or Form-1096, although certain payments to beneficiaries or employees may require use of Forms W–3 or W–2, respectively. Treas. Reg. sec. 1.6041–1(a)(2).
[71] Sec. 6041(a) requires reporting as to fixed or determinable gains, profits, and income (other than payments to which section 6042(a)(1), 6044(a)(1), 6047(c), 6049(a), or 6050N(a) applies and other than payments with respect to which a statement is required under authority of section 6042(a), 6044(a)(2) or 6045). These payments excepted from section 6041(a) include most interest, royalties, and dividends.
[72] Secs. 6042 (dividends), 6045 (broker reporting) and 6049 (interest) and the Treasury regulations thereunder.
[73] Sec. 6051(a).
[74] Sec. 6041A.
[75] Sec. 6050W.
[76] Sec. 6041(d).

the information return with the IRS on or before January 31 of the year following the calendar year to which such returns relate.[77]

Failure to comply with the information reporting requirements results in penalties, which may include a penalty for failure to file the information return,[78] to furnish payee statements,[79] or to comply with other various reporting requirements.[80] No penalty is imposed if the failure is due to reasonable cause.[81] Any person who is required to file an information return, but who fails to do so on or before the prescribed filing date is subject to a penalty that varies based on when, if at all, the correct information return is filed and the correct payee statement is furnished.

Books or records

Every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.[82] Whenever necessary, the Secretary may require any person, by notice served upon that person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not that person is liable for tax. Persons subject to income tax are required to keep books or records sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax or information.[83] The books or records are required to be kept available at all times for inspection by the IRS, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law.[84]

REASONS FOR CHANGE

The Committee recognizes that overclaims and overpayments are prevalent in the EIC program. The Committee further recognizes that the overwhelming majority of individuals making overclaims were not eligible for the credit. The Committee believes that these overclaims and overpayments can be significantly reduced by limiting earned income for purposes of the EIC to amounts that can be verified by third party reporting or the taxpayer.

EXPLANATION OF PROVISION

The provision limits earned income for purposes of the earned income credit to amounts substantiated by the taxpayer on statements furnished or returns filed under third party information reporting requirements, or amounts substantiated by the taxpayer's books and records. The authority of the IRS to make returns, render statements, or keep records and, pursuant to the Code, to make corresponding adjustments to income to reflect substantiated amounts for purposes other than the EIC remains unaffected by this provision.

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[77] Sec. 6071(d).
[78] Sec. 6721.
[79] Sec. 6722.
[80] Sec. 6723.
[81] Sec. 6724.
[82] Sec. 6001.
[83] Treas. sec. 1.6001–1(a).
[84] Treas. sec. 1.6001–1(e).

EFFECTIVE DATE

The provision is effective for taxable years ending after the date of enactment.

C. Simplification and Reform of Education Incentives

1. Reform of American Opportunity tax credit and repeal of Lifetime Learning credit (sec. 1201 of the bill and sec. 25A of the Code)

PRESENT LAW

American Opportunity credit

The American Opportunity credit provides individuals with a tax credit of up to $2,500 per eligible student per year for qualified tuition and related expenses (including course materials) paid for each of the first four years of the student's post-secondary education in a degree or certificate program. The credit rate is 100 percent on the first $2,000 of qualified tuition and related expenses, and 25 percent on the next $2,000 of qualified tuition and related expenses. The credit may not be claimed for more than four taxable years with respect to any student.

The American Opportunity credit is phased out ratably for taxpayers with modified AGI between $80,000 and $90,000 ($160,000 and $180,000 for married taxpayers filing a joint return). The credit may be claimed against a taxpayer's AMT liability.

Forty percent of a taxpayer's otherwise allowable modified credit is refundable. A refundable credit is a credit which, if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is payable to the taxpayer as a direct transfer payment.

A taxpayer may not claim the American Opportunity credit if the qualified tuition and related expenses for the enrollment or attendance of a student, if such student has been convicted of a Federal or State felony offense consisting of the possession or distribution of a controlled substance before the end of the taxable year.[85]

Lifetime learning credit

Individual taxpayers may be eligible to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. Up to $10,000 of qualified tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit (*i.e.,* the maximum credit per taxpayer return is $2,000).

In contrast to the American Opportunity credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years.[86] Also in contrast to the American Opportunity credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return does not vary based on the number of students in the taxpayer's family—that is, the American Opportunity credit is computed on a per-student basis while the Lifetime Learning credit is computed on a family-wide basis. The Lifetime

[85] Sec. 25A(b)(2)(D).

[86] Sec. 25A(a)(2).

Learning credit amount that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between $56,000 and $66,000 ($112,000 and $132,000 for married taxpayers filing a joint return) in 2017.

REASONS FOR CHANGE

The Committee believes that it is important to provide access to affordable, high-quality higher education. Combining the American Opportunity credit with elements of the Lifetime Learning Credit will continue to serve to make college more affordable, while also streamlining these tax provisions so that they are easier for families to apply—an important step towards consolidating duplicative Code provisions and simplifying the Code. The Committee believes that these changes will make the system simpler and fairer for all families and individuals.

EXPLANATION OF PROVISION

The provision modifies the American Opportunity credit [87] by providing that a credit may be claimed with respect to a student for five taxable years (rather than four taxable years under present law). For a credit claimed with respect to the student's fifth taxable year, the credit is half the value of the American Opportunity credit that is applicable to the first four taxable years (the refundable portion of the credit is 40-percent of the half-value credit). Additionally, the provision allows a student to claim the American Opportunity credit for any of the first five years of postsecondary education.

The operation of this provision is as follows. Assume that a student enters college in the Fall of 2018, attending for eight consecutive semesters, such that the student graduates in the Spring of 2022. Assume that qualifying tuition and fees for each semester is in excess of $5,000. For each of taxable years 2018, 2019, 2020 and 2021, an individual claiming the credit on behalf of the student would be eligible for the maximum credit of $2,500 (of which $1,000 is refundable). For taxable year 2022, a taxpayer claiming the credit on behalf of the student may be eligible for a $1,250 credit (of which $500 is refundable). Alternatively, if no credit were claimed with respect to the student in 2022, and the student were to decide to attend graduate school in the Fall of 2024, the student may claim the half-value fifth year credit ($1,250 ($500 refundable)) for the 2024 taxable year.

The provision repeals the lifetime learning credit.

EFFECTIVE DATE

The proposal applies to taxable years beginning after December 31, 2017.

[87] The provision also repeals the Hope credit, a precursor to the American Opportunity credit which since 2009 has been largely superseded in the Code by the American Opportunity credit.

2. Consolidation and modification of education savings rules (sec. 1202 of the bill and secs. 529 and 530 of the Code)

PRESENT LAW

Coverdell education savings accounts

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.[88] Annual contributions to Coverdell education savings accounts may not exceed $2,000 per designated beneficiary 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 taxpayers with modified AGI between $95,000 and $110,000 ($190,000 and $220,000 for married taxpayers filing a joint return); the AGI of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Earnings on contributions to a Coverdell education savings account generally are subject to tax when withdrawn.[89] However, distributions from a Coverdell education savings account are excludable from the gross income of the distributee (*i.e.,* the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell education savings account distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.[90]

Tax-free (and free of additional 10-percent tax) transfers or rollovers of account balances from one Coverdell education savings account benefiting one beneficiary to another Coverdell education savings account benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted, provided that the new beneficiary is a member of the family of the prior beneficiary and is under age 30 (except in the case of a special needs beneficiary). In general, any balance remaining in a Coverdell education savings account is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date that the beneficiary dies).

Qualified education expenses include qualified elementary and secondary expenses and qualified higher education expenses. Such qualified education expenses generally include only out-of-pocket expenses. They do not include expenses covered by employer-provided educational assistance or scholarships for the benefit of the beneficiary that are excludable from gross income.

The term qualified elementary and secondary school expenses, means expenses for: (1) tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or sec-

[88] Sec. 530.

[89] In addition, Coverdell education savings accounts are subject to the unrelated business income tax imposed by section 511.

[90] This 10-percent additional tax does not apply if a distribution from an education savings account is made on account of the death or disability of the designated beneficiary, or if made on account of a scholarship received by the designated beneficiary.

ondary education (kindergarten through grade 12) as determined under State law; (2) room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and (3) the purchase of any computer technology or equipment (as defined in section 170(e)(6)(F)(i)) or internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary's family during any of the years the beneficiary is in elementary or secondary school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is predominantly educational in nature.

The term qualified higher education expenses includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis.[91] Moreover, qualified higher education expenses include certain room and board expenses for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified tuition program for the benefit of the beneficiary of the Coverdell education savings account.[92]

Section 529 qualified tuition programs

In general

A qualified tuition program is a program established and maintained by a State or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the beneficiary (a "prepaid tuition program"). Section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs.[93] In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a "savings account program"). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary's higher education expenses.

[91] Qualified higher education expenses are defined in the same manner as for qualified tuition programs.
[92] Sec. 530(b)(2)(B).
[93] For purposes of this description, the term "account" is used interchangeably to refer to a prepaid tuition benefit contract or a tuition savings account established pursuant to a qualified tuition program.

In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary. Decisions with respect to the contract or account are typically made by an individual who is not the designated beneficiary. Qualified tuition accounts or contracts generally require the designation of a person (generally referred to as an "account owner")[94] whom the program administrator (oftentimes a third party administrator retained by the State or by the educational institution that established the program) may look to for decisions, recordkeeping, and reporting with respect to the account established for a designated beneficiary. The person or persons who make the contributions to the account need not be the same person who is regarded as the account owner for purposes of administering the account. Under many qualified tuition programs, the account owner generally has control over the account or contract, including the ability to change designated beneficiaries and to withdraw funds at any time and for any purpose. Thus, in practice, qualified tuition accounts or contracts generally involve a contributor, a designated beneficiary, an account owner (who oftentimes is not the contributor or the designated beneficiary), and an administrator of the account or contract.

Qualified higher education expenses

For purposes of receiving a distribution from a qualified tuition program that qualifies for favorable tax treatment under the Code, qualified higher education expenses means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and expenses for special needs services in the case of a special needs beneficiary that are incurred in connection with such enrollment or attendance. Qualified higher education expenses generally also include room and board for students who are enrolled at least half-time. Qualified higher education expenses include the purchase of any computer technology or equipment, or Internet access or related services, if such technology or services were to be used primarily by the beneficiary during any of the years a beneficiary is enrolled at an eligible institution.

Contributions to qualified tuition programs

Contributions to a qualified tuition program must be made in cash. Section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary's qualified higher education expenses. Contributions generally are treated as a completed gift eligible for the gift tax annual exclusion. Contributions are not tax deductible for Federal income tax purposes, although they may be deductible for State income tax purposes. Amounts in the account accumulate on a tax-free basis (*i.e.,* income on accounts in the plan is not subject to current income tax).

[94] Section 529 refers to contributors and designated beneficiaries, but does not define or otherwise refer to the term "account owner," which is a commonly used term among qualified tuition programs.

A qualified tuition program may not permit any contributor to, or designated beneficiary under, the program to direct (directly or indirectly) the investment of any contributions (or earnings thereon) more than two times in any calendar year, and must provide separate accounting for each designated beneficiary. A qualified tuition program may not allow any interest in an account or contract (or any portion thereof) to be used as security for a loan.

REASONS FOR CHANGE

The Committee believes that expanding and strengthening the 529 program will help families have the ability to save for future college expenses. Additionally, the Committee believes that replacing Coverdell savings accounts with an expanded 529 program that allows individuals to save for primary and secondary school tuition is an important step towards consolidating duplicative Code provisions and simplifying the Code.

EXPLANATION OF PROVISION

Under the provision, no new contributions are permitted into Coverdell savings accounts after December 31, 2017. However, rollovers of account balances from one Coverdell education savings account to another pre-existing Coverdell education savings account benefiting another beneficiary remain permitted after this date. Additionally, the provision allows section 529 plans to receive rollover contributions from Coverdell education savings accounts.

The provision modifies section 529 plans to allow such plans to distribute not more than $10,000 in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, private or religious elementary or secondary school. This limitation applies on a per-student basis, rather than a per-account basis. Thus, under the provision, although an individual may be the designated beneficiary of multiple accounts, that individual may receive a maximum of $10,000 in distributions free of tax, regardless of whether the funds are distributed from multiple accounts. Any excess distributions received by the individual would be treated as a distribution subject to tax under the general rules of section 529.

The provision also modifies section 529 plans to allow such plan distributions to be used for certain expenses, including books, supplies, and equipment, required for attendance in a registered apprenticeship program. Registered apprenticeship programs are apprenticeship programs registered and certified with the Secretary of Labor.

Finally, the provision specifies that nothing in this section shall prevent an unborn child from qualifying as a designated beneficiary. For these purposes, an unborn child means a child *in utero,* and the term child *in utero* means a member of the species *homo sapiens,* at any stage of development, who is carried in the womb.

EFFECTIVE DATE

The provision applies to contributions and distributions made after December 31, 2017.

3. Reforms to discharge of certain student loan indebtedness (sec. 1203 of the bill and sec. 108(f) of the Code)

PRESENT LAW

Gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.[95]

Student loans eligible for this special rule must be made to an individual to assist the individual in attending an educational institution that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its education activities are regularly carried on. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses. The loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation.

In addition, an individual's gross income does not include amounts from the forgiveness of loans made by educational organizations (and certain tax-exempt organizations in the case of refinancing loans) out of private, nongovernmental funds if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans (not just loans made by educational organizations) and the student is not employed by the lender organization. In the case of such loans made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), cancellation of the student loan must be contingent on the student working in an occupation or area with unmet needs and such work must be performed for, or under the direction of, a tax-exempt charitable organization or a governmental entity.

Finally, an individual's gross income does not include any loan repayment amount received under the National Health Service Corps loan repayment program, certain State loan repayment programs, or any amount received by an individual under any State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by the State).

REASONS FOR CHANGE

The Committee believes that the discharge of a student loan in the case of an individual whose loan was discharged on account of death or disability of the student borrower should not be a taxable event.

[95] Sec. 108(f).

EXPLANATION OF PROVISION

The provision modifies the exclusion of student loan discharges from gross income, by including within the exclusion certain discharges on account of death or disability. Loans eligible for the exclusion under the provision are loans made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation, or (5) private education loans (for this purpose, private education loan is defined in section 140(7) of the Consumer Protection Act).[96]

Under the provision, the discharge of a loan as described above is excluded from gross income if the discharge was pursuant to the death or total and permanent disability of the student.[97]

Additionally, the provision modifies the gross income exclusion for amounts received under the National Health Service Corps loan repayment program or certain State loan repayment programs to include any amount received by an individual under the Indian Health Service loan repayment program.[98]

EFFECTIVE DATE

The provision applies to discharges of loans after, and amounts received after, December 31, 2017.

4. Repeal of deduction for student loan interest (sec. 1204 of the bill and sec. 221 of the Code)

PRESENT LAW

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit.[99] Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.[100]

A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was in-

[96] 15 U.S.C. 1650(7).

[97] Although the provision makes specific reference to those provisions of the Higher Education Act of 1965 that discharge William D. Ford Federal Direct Loan Program loans, Federal Family Education Loan Program loans, and Federal Perkins Loan Program loans in the case of death and total and permanent disability, the provision also contains a catch-all exclusion in the case of a student loan discharged on account of the death or total and permanent disability of the student, in addition to those specific statutory references.

[98] Section 108 of the Indian Health Care Improvement Act established the Indian Health Service loan repayment program to assure a sufficient supply of trained health professionals needed to provide health care services to Indians. Pub. L. No. 94–437, as amended by Pub. L. No. 100–713, sec. 108, and Pub. L. No. 102–573, sec. 106, and as amended, and permanently reauthorized by Pub. L. No. 111–148, sec. 10221.

[99] Sec. 221.

[100] Sec. 221(c).

curred in attending on at least a half-time basis (1) eligible educational institutions, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. The cost of attendance is reduced by any amount excluded from gross income under the exclusions for qualified scholarships and tuition reductions, employer-provided educational assistance, interest earned on education savings bonds, qualified tuition programs, and Coverdell education savings accounts, as well as the amount of certain other scholarships and similar payments.

The maximum allowable deduction per year is $2,500.[101] For 2017, the deduction is phased out ratably for taxpayers with AGI between $65,000 and $80,000 ($135,000 and $165,000 for married taxpayers filing a joint return). The income phase-out ranges are indexed for inflation and rounded to the next lowest multiple of $5,000.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for student loan interest, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals the deduction for student loan interest.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

5. Repeal of deduction for qualified tuition and related expenses (sec. 1204 of the bill and sec. 222 of the Code)

PRESENT LAW

For taxable years beginning before January 1, 2017, an individual is allowed an above-the-line deduction for qualified tuition and related expenses for higher education paid by the individual during the taxable year.[102] Qualified tuition includes tuition and fees required for the enrollment or attendance by the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer may claim a personal exemption, at an eligible institution of higher education for courses of instruction of such individual at such institution. The expenses must be in connection with enrollment at an institution of higher education during the taxable year, or with an academic term beginning during the taxable year or during the first three months of the next taxable year. The deduction is not available for tuition and related expenses paid for elementary or secondary education.

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[101] Sec. 221(b)(1).
[102] Sec. 222(a).

The maximum deduction is $4,000 for an individual whose AGI for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), or $2,000 for other individuals whose AGI does not exceed $80,000 ($160,000 in the case of a joint return).[103] No deduction is allowed for an individual whose AGI exceeds the relevant AGI limitations, for a married individual who does not file a joint return, or for an individual with respect to whom a personal exemption deduction may be claimed by another taxpayer for the taxable year. The deduction is not available for taxable years beginning after December 31, 2016.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for tuition, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals the deduction for qualified tuition and related expenses.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

6. Repeal of exclusion for educational assistance programs (sec. 1204 of the bill and sec. 127 of the Code)

PRESENT LAW

Up to $5,250 annually of educational assistance provided by an employer to an employee is excludible from the employee's gross income, provided that certain requirements are satisfied.[104] Nondiscrimination rules[105] apply and the educational assistance must be provided pursuant to a separate written plan of the employer. The exclusion applies to both graduate and undergraduate courses, and applies only with respect to education provided to the employee (*i.e.*, it does not apply to education provided to the spouse or a child of the employee). Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

For purposes of the exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including

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[103] Sec. 222(b)(2)(B).

[104] Sec. 127(a).

[105] The employer's educational assistance program must not discriminate in favor of highly compensated employees, within the meaning of Sec. 414(q). In addition, no more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program can be provided for the class of individuals consisting of more-than-five-percent owners of the employer and the spouses or dependents of such more-than-five-percent owners.

books, supplies, and equipment). Educational assistance does not include (1) tools or supplies that may be retained by the employee after completion of a course, (2) meals, lodging, or transportation, and (3) any education involving sports, games, or hobbies.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the exclusion for educational assistance programs, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals the exclusions from gross income and wages for educational assistance programs.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

7. Repeal of exclusion for interest on United States savings bonds used for higher education expenses (sec. 1204 of the bill and sec. 135 of the Code)

PRESENT LAW

Interest earned on a qualified United States Series EE savings bond issued after 1989 is excludable from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year.[106] Qualified higher education expenses include tuition and fees (but not room and board expenses) required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at certain eligible higher educational institutions. The amount of qualified higher education expenses taken into account for purposes of the exclusion is reduced by the amount of such expenses taken into account in determining the Hope, American Opportunity, or Lifetime Learning credits claimed by any taxpayer, or taken into account in determining an exclusion from gross income for a distribution from a qualified tuition program or a Coverdell education savings account, with respect to a particular student for the taxable year.

The exclusion is phased out for certain higher-income taxpayers, determined by the taxpayer's modified AGI during the year the bond is redeemed. For 2017, the exclusion is phased out for taxpayers with modified AGI between $78,150 and $93,150 ($117,250 and $147,250 for married taxpayers filing a joint return). To prevent taxpayers from effectively avoiding the income phaseout limitation through the purchase of bonds directly in the child's name, the interest exclusion is available only with respect to U.S. Series EE savings bonds issued to taxpayers who are at least 24 years old.

[106] Sec. 135.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the exclusion for interest on United States savings bonds used for higher education expenses, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals exclusion for interest on Series EE savings bonds used for qualified higher education expenses.

EFFECTIVE DATE

The provision generally applies to taxable years beginning after December 31, 2017.

8. Repeal of exclusion for qualified tuition reductions (sec. 1204 of the bill and sec. 117(d) of the Code)

PRESENT LAW

Qualified tuition reductions for certain education provided to employees (and their spouses and dependents [107]) of certain educational organizations are excludible from gross income.[108] The tuition reduction is subject to nondiscrimination rules.[109] The exclusion generally applies below the graduate level, and to teaching and research assistants who are students at the graduate level, but does not apply to any amount received by a student that represents payment for teaching, research or other services by the student required as a condition for receiving the tuition reduction. Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the exclusion for qualified tuition reductions, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals the exclusions from gross income and wages for qualified tuition reductions.

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[107] Individuals described under the rules of Sec. 132(h).

[108] Educational organization described in section 170(b)(1)(A)(ii). Sec. 117(d)(2).

[109] The exclusion applies with respect to highly compensated employees, within the meaning of Sec. 414(q), only if such tuition reductions are available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification established by the employer, such that the benefit does not discriminate in favor of highly compensated employees.

EFFECTIVE DATE

The provision applies to amounts paid or incurred after December 31, 2017.

9. Rollovers between qualified tuition programs and qualified ABLE programs (sec. 1205 of the bill and secs. 529 and 529A of the Code)

PRESENT LAW [110]

Qualified ABLE programs

The Code provides for a tax-favored savings program intended to benefit disabled individuals, known as qualified ABLE programs.[111] A qualified ABLE program is a program established and maintained by a State or agency or instrumentality thereof. A qualified ABLE program must meet the following conditions: (1) under the provisions of the program, contributions may be made to an account (an "ABLE account"), established for the purpose of meeting the qualified disability expenses of the designated beneficiary of the account; (2) the program must limit a designated beneficiary to one ABLE account; and (3) the program must meet certain other requirements discussed below. A qualified ABLE program is generally exempt from income tax, but is otherwise subject to the taxes imposed on the unrelated business income of tax-exempt organizations.

A designated beneficiary of an ABLE account is the owner of the ABLE account. A designated beneficiary must be an eligible individual (defined below) who established the ABLE account and who is designated at the commencement of participation in the qualified ABLE program as the beneficiary of amounts paid (or to be paid) into and from the program.

Contributions to an ABLE account must be made in cash and are not deductible for Federal income tax purposes. Except in the case of a rollover contribution from another ABLE account, an ABLE account must provide that it may not receive aggregate contributions during a taxable year in excess of the amount under section 2503(b) of the Code (the annual gift tax exemption). For 2017, this is $14,000.[112] Additionally, a qualified ABLE program must provide adequate safeguards to ensure that ABLE account contributions do not exceed the limit imposed on accounts under the qualified tuition program of the State maintaining the qualified ABLE program. Amounts in the account accumulate on a tax-deferred basis (i.e., income on accounts under the program is not subject to current income tax).

A qualified ABLE program may permit a designated beneficiary to direct (directly or indirectly) the investment of any contributions (or earnings thereon) no more than two times in any calendar year and must provide separate accounting for each designated bene-

[110] For a description of qualified tuition programs (also known as 529 plans), see the description of sec. 1203 of the bill.

[111] Sec. 529A.

[112] This amount is indexed for inflation. In the case that contributions to an ABLE account exceed the annual limit, an excise tax in the amount of six percent of the excess contribution to such account is imposed on the designated beneficiary. Such tax does not apply in the event that the trustee of such account makes a corrective distribution of such excess amounts by the due date (including extensions) of the individual's tax return for the year within the taxable year.

ficiary. A qualified ABLE program may not allow any interest in the program (or any portion thereof) to be used as security for a loan.

Distributions from an ABLE account are generally includible in the distributee's income to the extent consisting of earnings on the account.[113] Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of the designated beneficiary during the taxable year. If a distribution from an ABLE account exceeds the qualified disability expenses of the designated beneficiary, a pro rata portion of the distribution is excludable from income. The portion of any distribution that is includible in income is subject to an additional 10-percent tax unless the distribution is made after the death of the beneficiary. Amounts in an ABLE account may be rolled over without income tax liability to another ABLE account for the same beneficiary[114] or another ABLE account for the designated beneficiary's brother, sister, stepbrother or stepsister who is also an eligible individual.

Except in the case of an ABLE account established in a different ABLE program for purposes of transferring ABLE accounts,[115] no more than one ABLE account may be established by a designated beneficiary. Thus, once an ABLE account has been established by a designated beneficiary, no account subsequently established by such beneficiary shall be treated as an ABLE account.

A contribution to an ABLE account is treated as a completed gift of a present interest to the designated beneficiary of the account. Such contributions qualify for the per-donee annual gift tax exclusion ($14,000 for 2017) and, to the extent of such exclusion, are exempt from the generation skipping transfer ("GST") tax. A distribution from an ABLE account generally is not subject to gift tax or GST tax.

Eligible individuals

As described above, a qualified ABLE program may provide for the establishment of ABLE accounts only if those accounts are established and owned by an eligible individual, such owner referred to as a designated beneficiary. For these purposes, an eligible individual is an individual either (1) for whom a disability certification has been filed with the Secretary for the taxable year, or (2) who is entitled to Social Security Disability Insurance benefits or SSI benefits[116] based on blindness or disability, and such blindness or disability occurred before the individual attained age 26.

A disability certification means a certification to the satisfaction of the Secretary, made by the eligible individual or the parent or guardian of the eligible individual, that the individual has a medically determinable physical or mental impairment, which results in marked and severe functional limitations, and which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months, or is blind (within the meaning of section 1614(a)(2) of the Social Secu-

[113] The rules of section 72 apply in determining the portion of a distribution that consists of earnings.
[114] For instance, if a designated beneficiary were to relocate to a different State.
[115] In which case the contributor ABLE account must be closed 60 days after the transfer to the new ABLE account is made.
[116] These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

rity Act). Such blindness or disability must have occurred before the date the individual attained age 26. Such certification must include a copy of the diagnosis of the individual's impairment and be signed by a licensed physician.[117]

Qualified disability expenses

As described above, the earnings on distributions from an ABLE account are excluded from income only to the extent total distributions do not exceed the qualified disability expenses of the designated beneficiary. For this purpose, qualified disability expenses are any expenses related to the eligible individual's blindness or disability which are made for the benefit of the designated beneficiary. Such expenses include the following expenses: education, housing, transportation, employment training and support, assistive technology and personal support services, health, prevention and wellness, financial management and administrative services, legal fees, expenses for oversight and monitoring, funeral and burial expenses, and other expenses, which are approved by the Secretary under regulations and consistent with the purposes of section 529A.

Transfer to State

In the event that the designated beneficiary dies, subject to any outstanding payments due for qualified disability expenses incurred by the designated beneficiary, all amounts remaining in the deceased designated beneficiary's ABLE account not in excess of the amount equal to the total medical assistance paid such individual under any State Medicaid plan established under title XIX of the Social Security Act shall be distributed to such State upon filing of a claim for payment by such State. Such repaid amounts shall be net of any premiums paid from the account or by or on behalf of the beneficiary to the State's Medicaid Buy-In program.

Treatment of ABLE accounts under Federal programs

Any amounts in an ABLE account, and any distribution for qualified disability expenses, shall be disregarded for purposes of determining eligibility to receive, or the amount of, any assistance or benefit authorized by any Federal means-tested program. However, in the case of the SSI program, a distribution for housing expenses is not disregarded, nor are amounts in an ABLE account in excess of $100,000. In the case that an individual's ABLE account balance exceeds $100,000, such individual's SSI benefits shall not be terminated, but instead shall be suspended until such time as the individual's resources fall below $100,000. However, such suspension shall not apply for purposes of Medicaid eligibility.

REASONS FOR CHANGE

ABLE programs can be viewed as an alternative to college savings, allowing a parent to save for a child with a disability in the same way a parent might save for a child to go to college. The Committee believes that families should have the flexibility to transition between these savings vehicles by allowing amounts

[117] No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

saved in a section 529 account to be transferred to an ABLE account tax-free."

EXPLANATION OF PROVISION

The provision allows for amounts from qualified tuition programs (also known as 529 accounts) to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 account, or a member of such designated beneficiary's family.[118] Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year.[119] Any amount rolled over that is in excess of this limitation shall be includible in the gross income of the distributee in a manner provided by section 72.[120]

EFFECTIVE DATE

The provision applies to distributions after December 31, 2017.

D. Simplification and Reform of Deductions

1. Repeal of overall limitation on itemized deductions (sec. 1301 of the bill and sec. 68 of the Code)

PRESENT LAW

The total amount of most otherwise allowable itemized deductions (other than the deductions for medical expenses, investment interest and casualty, theft or gambling losses) is limited for certain upper-income taxpayers.[121] All other limitations applicable to such deductions (such as the separate floors) are first applied and, then, the otherwise allowable total amount of itemized deductions is reduced by three percent of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount.

For 2017, the threshold amounts are $261,500 for single taxpayers, $287,650 for heads of household, $313,800 for married couples filing jointly, and $156,900 for married taxpayers filing separately. These threshold amounts are indexed for inflation. The otherwise allowable itemized deductions may not be reduced by more than 80 percent by reason of the overall limit on itemized deductions.

REASONS FOR CHANGE

The Committee believes that the overall limitation on itemized deductions has functioned as a hidden marginal tax rate. In its mission to make the Code simpler, fairer, and more transparent, the Committee believes that the provision should be repealed.

[118] For these purposes, a member of the family means, with respect to any designated beneficiary, the taxpayer's: (1) spouse; (2) child or descendant of a child; (3) brother, sister, stepbrother or stepsister; (4) father, mother or ancestor of either; (5) stepfather or stepmother; (6) niece or nephew; (7) aunt or uncle; (8) in-law; (9) the spouse of any individual described in (2)-(8); and (10) any first cousin of the designated beneficiary.

[119] 529A(b)(2)(B).

[120] 529(c)(3)(A).

[121] Sec. 68.

EXPLANATION OF PROVISION

The provision repeals the overall limitation on itemized deductions.

EFFECTIVE DATE

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

2. Modification of deduction for home mortgage interest (sec. 1302 of the bill and sec. 163(h) of the Code)

PRESENT LAW

As a general matter, personal interest is not deductible.[122] Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations.[123] Qualified residence interest means interest paid or accrued during the taxable year on either acquisition indebtedness or home equity indebtedness. A qualified residence means the taxpayer's principal residence and one other residence of the taxpayer selected to be a qualified residence. A qualified residence can be a house, condominium, cooperative, mobile home, house trailer, or boat.

Acquisition indebtedness

Acquisition indebtedness is indebtedness that is incurred in acquiring, constructing, or substantially improving a qualified residence of the taxpayer and which secures the residence. The maximum amount treated as acquisition indebtedness is $1 million ($500,000 in the case of a married person filing a separate return).

Acquisition indebtedness also includes indebtedness from the refinancing of other acquisition indebtedness but only to the extent of the amount (and term) of the refinanced indebtedness. Thus, for example, if the taxpayer incurs $200,000 of acquisition indebtedness to acquire a principal residence and pays down the debt to $150,000, the taxpayer's acquisition indebtedness with respect to the residence cannot thereafter be increased above $150,000 (except by indebtedness incurred to substantially improve the residence).

Interest on acquisition indebtedness is allowable in computing alternative minimum taxable income. However, in the case of a second residence, the acquisition indebtedness may only be incurred with respect to a house, apartment, condominium, or a mobile home that is not used on a transient basis.

Home equity indebtedness

Home equity indebtedness is indebtedness (other than acquisition indebtedness) secured by a qualified residence.

The amount of home equity indebtedness may not exceed $100,000 ($50,000 in the case of a married individual filing a separate return) and may not exceed the fair market value of the residence reduced by the acquisition indebtedness.

Interest on home equity indebtedness is not deductible in computing alternative minimum taxable income.

[122] Sec. 163(h)(1).
[123] Sec. 163(h)(2)(D) and (h)(3).

Interest on qualifying home equity indebtedness is deductible, regardless of how the proceeds of the indebtedness are used. For example, personal expenditures may include health costs and education expenses for the taxpayer's family members or any other personal expenses such as vacations, furniture, or automobiles. A taxpayer and a mortgage company can contract for the home equity indebtedness loan proceeds to be transferred to the taxpayer in a lump sum payment (*e.g.*, a traditional mortgage), a series of payments (*e.g.*, a reverse mortgage), or the lender may extend the borrower a line of credit up to a fixed limit over the term of the loan (*e.g.*, a home equity line of credit).

Thus, the aggregate limitation on the total amount of a taxpayer's acquisition indebtedness and home equity indebtedness with respect to a taxpayer's principal residence and a second residence that may give rise to deductible interest is $1,100,000 ($550,000, for married persons filing a separate return).

REASONS FOR CHANGE

The Committee believes that scaling back existing tax incentives, including the home mortgage interest deduction, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that modification of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision modifies the home mortgage interest deduction in the following ways.

First, under the provision, only interest paid on indebtedness used to acquire, construct or substantially improve the taxpayer's principal residence may be included in the calculation of the deduction. Thus, under the provision, a taxpayer receives no deduction for interest paid on indebtedness used to acquire a second home.

Second, under the provision, a taxpayer may treat no more than $500,000 as principal residence acquisition indebtedness ($250,000 in the case of married taxpayers filing separately). In the case of principal residence acquisition indebtedness incurred before the date of introduction (November 2, 2017), this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately).[124] Although the term principal residence acquisition indebtedness is not defined in the statute, it is intended that this "grandfathering" provision apply only with respect to indebtedness incurred with respect to a taxpayer's principal residence.

Last, under the provision, interest paid on home equity indebtedness is not treated as qualified residence interest, and thus is not deductible. This is the case regardless of when the home equity indebtedness was incurred.

[124] Special rules apply in the case of indebtedness from refinancing existing principal residence acquisition indebtedness. Specifically, the $1,000,000 ($500,000 in the case of married taxpayers filing separately) limitation continues to apply to any indebtedness incurred on or after November 2, 2017, to refinance qualified residence indebtedness incurred before that date to the extent the amount of the indebtedness resulting from the refinancing does not exceed the amount of the refinanced indebtedness. Thus, the maximum dollar amount that may be treated as principal residence acquisition indebtedness will not decrease by reason of a refinancing.

EFFECTIVE DATE

The provision is effective for interest paid or accrued in taxable years beginning after December 31, 2017.

3. Modification of deduction for taxes not paid or accrued in a trade or business (sec. 1303 of the bill and sec. 164(b) of the Code)

PRESENT LAW

Individuals are permitted a deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business. These taxes are: (i) State and local real and foreign property taxes;[125] (ii) State and local personal property taxes;[126] (iii) State, local, and foreign income, war profits, and excess profits taxes.[127] At the election of the taxpayer, an itemized deduction may be taken for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes.[128]

Property taxes may be allowed as a deduction in computing adjusted gross income if incurred in connection with property used in a trade or business; otherwise they are an itemized deduction. In the case of State and local income taxes, the deduction is an itemized deduction notwithstanding that the tax may be imposed on profits from a trade or business.[129]

Individuals also are permitted a deduction for Federal and State generation skipping transfer tax ("GST tax") imposed on certain income distributions that are included in the gross income of the distributee.[130]

In determining a taxpayer's alternative minimum taxable income, no itemized deduction for property, income, or sales tax is allowed.

REASONS FOR CHANGE

The Committee believe that scaling back existing tax incentives, including the deduction for State and local taxes, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that modification of this provision to apply only to real property taxes is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

Under the provision, in the case of an individual, as a general matter, State, local, and foreign property taxes and State and local sales taxes are allowed as a deduction only when paid or accrued in carrying on a trade or business, or an activity described in section 212 (relating to expenses for the production of income).[131]

[125] Sec. 164(a)(1).
[126] Sec. 164(a)(2).
[127] Sec. 164(a)(3). A foreign tax credit, in lieu of a deduction, is allowable for foreign taxes if the taxpayer so elects.
[128] Sec. 164(b)(5).
[129] See H. Rep. No. 1365 to accompany Individual Income Tax Bill of 1944 (78th Cong., 2d. Sess.), reprinted at 19 C.B. 839 (1944).
[130] Sec. 164(a)(4).
[131] The proposal does not modify the deductibility of GST tax imposed on certain income distributions.

Thus, the provision allows only those deductions for State, local, and foreign property taxes, and sales taxes, that are presently deductible in computing income on an individual's Schedule C, Schedule E, or Schedule F on such individual's tax return. Thus, for instance, in the case of property taxes, an individual may deduct such items only if these taxes were imposed on business assets (such as residential rental property).

The provision contains an exception to the above-stated rule in the case of real property taxes. Under this exception, an individual may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for property taxes paid or accrued in the taxable year, in addition to any property taxes deducted in carrying on a trade or business or an activity described in section 212. Foreign real property taxes may not be deducted under this exception.

Under the provision, in the case of an individual, State and local income, war profits, and excess profits taxes are not allowable as a deduction.

It is intended that persons required to report refunds of State and local income taxes under section 6050E should no longer be required to report such refunds of tax relating to taxable years beginning after December 31, 2017. A technical amendment may be needed to reflect this intent.

EFFECTIVE DATE

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

4. Repeal of deduction for personal casualty and theft losses (sec. 1304 of the bill and sec. 165 of the Code)

PRESENT LAW

A taxpayer may generally claim a deduction for any loss sustained during the taxable year, not compensated by insurance or otherwise. For individual taxpayers, deductible losses must be incurred in a trade or business or other profit-seeking activity or consist of property losses arising from fire, storm, shipwreck, or other casualty, or from theft.[132] Personal casualty or theft losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate net casualty and theft losses are deductible only to the extent they exceed 10 percent of an individual taxpayer's adjusted gross income.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for personal casualty and theft losses, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

[132] Sec. 165(c).

EXPLANATION OF PROVISION

The provision repeals the deduction for personal casualty and theft losses. However, notwithstanding the repeal of the deduction, the provision retains the benefit of the deduction, as modified by the Disaster Tax Relief and Airport and Airway Extension Act of 2017,[133] for those individuals who sustained a personal casualty loss arising from hurricanes Harvey, Irma, or Maria.

EFFECTIVE DATE

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

5. Limitation on wagering losses (sec. 1305 of the bill and sec. 165 of the Code)

PRESENT LAW

Losses sustained during the taxable year on wagering transactions are allowed as a deduction only to the extent of the gains during the taxable year from such transactions.[134]

REASONS FOR CHANGE

The Committee believes that the scope of the limitation on wagering losses should be broadened to cover expenses incurred in the conduct of the individual's gambling activity.

EXPLANATION OF PROVISION

The provision clarifies the scope of "losses from wagering transactions" as that term is used in section 165(d). Under the provision, this term includes any deduction otherwise allowable under chapter 1 of the Code incurred in carrying on any wagering transaction.

The provision is intended to clarify that the limitation on losses from wagering transactions applies not only to the actual costs of wagers incurred by an individual, but to other expenses incurred by the individual in connection with the conduct of that individual's gambling activity.[135] The provision clarifies, for instance, an individual's otherwise deductible expenses in traveling to or from a casino are subject to the limitation under section 165(d).

EFFECTIVE DATE

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

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[133] Pub. L. No. 115–63.

[134] Sec. 165(d).

[135] The provision thus reverses the result reached by the Tax Court in *Ronald A. Mayo* v. *Commissioner,* 136 T.C. 81 (2011). In that case, the Court held that a taxpayer's expenses incurred in the conduct of the trade or business of gambling, other than the cost of wagers, were not limited by sec. 165(d), and were thus deductible under sec. 162(a).

6. Modifications to the deduction for charitable contributions (sec. 1306 of the bill and sec. 170 of the Code)

PRESENT LAW

In general

The Internal Revenue Code allows taxpayers to reduce their income tax liability by taking deductions for contributions to certain organizations, including charities, Federal, State, local, and Indian tribal governments, and certain other organizations.

To be deductible, a charitable contribution generally must meet several threshold requirements. First, the recipient of the transfer must be eligible to receive charitable contributions (*i.e.,* an organization or entity described in section 170(c)). Second, the transfer must be made with gratuitous intent and without the expectation of a benefit of substantial economic value in return. Third, the transfer must be complete and generally must be a transfer of a donor's entire interest in the contributed property (*i.e.,* not a contingent or partial interest contribution). To qualify for a current year charitable deduction, payment of the contribution must be made within the taxable year.[136] Fourth, the transfer must be of money or property—contributions of services are not deductible.[137] Finally, the transfer must be substantiated and in the proper form.

As discussed below, special rules limit the deductibility of a taxpayer's charitable contributions in a given year to a percentage of income, and those rules, in part, turn on whether the organization receiving the contributions is a public charity or a private foundation. Other special rules determine the deductible value of contributed property for each type of property.

Contributions of partial interests in property

In general

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity while retaining an interest in that property or transferring an interest in that property to a noncharity for less than full and adequate consideration.[138] This rule of nondeductibility, often referred to as the partial interest rule, generally prohibits a charitable deduction for contributions of income interests, remainder interests, or rights to use property.

A charitable contribution deduction generally is not allowable for a contribution of a future interest in tangible personal property.[139] For this purpose, a future interest is one "in which a donor purports to give tangible personal property to a charitable organization, but has an understanding, arrangement, agreement, etc., whether written or oral, with the charitable organization that has

[136] Sec. 170(a)(1).

[137] For example, as discussed in greater detail below, the value of time spent volunteering for a charitable organization is not deductible. Incidental expenses such as mileage, supplies, or other expenses incurred while volunteering for a charitable organization, however, may be deductible.

[138] Secs. 170(f)(3)(A) (income tax), 2055(e)(2) (estate tax), and 2522(c)(2) (gift tax).

[139] Sec. 170(a)(3).

the effect of reserving to, or retaining in, such donor a right to the use, possession, or enjoyment of the property."[140]

A gift of an undivided portion of a donor's entire interest in property generally is not treated as a nondeductible gift of a partial interest in property.[141] For this purpose, an undivided portion of a donor's entire interest in property must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property.[142] A gift generally is treated as a gift of an undivided portion of a donor's entire interest in property if the donee is given the right, as a tenant in common with the donor, to possession, dominion, and control of the property for a portion of each year appropriate to its interest in such property.[143]

Other exceptions to the partial interest rule are provided for, among other interests: (1) remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds; (2) present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property; (3) a remainder interest in a personal residence or farm; and (4) qualified conservation contributions.

Qualified conservation contributions

Qualified conservation contributions are not subject to the partial interest rule, which generally bars deductions for charitable contributions of partial interests in property.[144] A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest; (2) a remainder interest; or (3) a restriction (granted in perpetuity) on the use that may be made of the real property (generally, a conservation easement). Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

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[140] Treas. Reg. sec. 1.170A–5(a)(4). Treasury regulations provide that section 170(a)(3), which generally denies a deduction for a contribution of a future interest in tangible personal property, has "no application in respect of a transfer of an undivided present interest in property. For example, a contribution of an undivided one-quarter interest in a painting with respect to which the donee is entitled to possession during three months of each year shall be treated as made upon the receipt by the donee of a formally executed and acknowledged deed of gift. However, the period of initial possession by the donee may not be deferred in time for more than one year." Treas. Reg. sec. 1.170A–5(a)(2).

[141] Sec. 170(f)(3)(B)(ii).

[142] Treas. Reg. sec. 1.170A–7(b)(1).

[143] Treas. Reg. sec. 1.170A–7(b)(1).

[144] Secs. 170(f)(3)(B)(iii) and 170(h).

Percentage limits on charitable contributions

Individual taxpayers

Charitable contributions by individual taxpayers are limited to a specified percentage of the individual's contribution base. The contribution base is the taxpayer's adjusted gross income ("AGI") for a taxable year, disregarding any net operating loss carryback to the year under section 172.[145] In general, more favorable (higher) percentage limits apply to contributions of cash and ordinary income property than to contributions of capital gain property. More favorable limits also generally apply to contributions to public charities (and certain operating foundations) than to contributions to nonoperating private foundations.

More specifically, the deduction for charitable contributions by an individual taxpayer of cash and property that is not appreciated to a charitable organization described in section 170(b)(1)(A) (public charities, private foundations other than nonoperating private foundations, and certain governmental units) may not exceed 50 percent of the taxpayer's contribution base. Contributions of this type of property to nonoperating private foundations generally may be deducted up to the lesser of 30 percent of the taxpayer's contribution base or the excess of (i) 50 percent of the contribution base over (ii) the amount of contributions subject to the 50 percent limitation.

Contributions of appreciated capital gain property to public charities and other organizations described in section 170(b)(1)(A) generally are deductible up to 30 percent of the taxpayer's contribution base (after taking into account contributions other than contributions of capital gain property). An individual may elect, however, to bring all these contributions of appreciated capital gain property for a taxable year within the 50-percent limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of appreciated capital gain property to nonoperating private foundations are deductible up to the lesser of 20 percent of the taxpayer's contribution base or the excess of (i) 30 percent of the contribution base over (ii) the amount of contributions subject to the 30 percent limitation.

Finally, contributions that are for the use of (not to) the donee charity get less favorable percentage limits. Contributions of capital gain property for the use of public charities and other organizations described in section 170(b)(1)(A) also are limited to 20 percent of the taxpayer's contribution base. Property contributed for the use of an organization generally has been interpreted to mean property contributed in trust for the organization.[146] Charitable contributions of income interests (where deductible) also generally are treated as contributions for the use of the donee organization.

[145] Sec. 170(b)(1)(G).
[146] *Rockefeller v. Commissioner*, 676 F.2d 35, 39 (2d Cir. 1982).

Table 3—CHARITABLE CONTRIBUTION PERCENTAGE LIMITS FOR INDIVIDUAL TAXPAYERS [147]

	Ordinary Income Property and Cash	Capital Gain Property to the Recipient [148]	Capital Gain Property for the use of the Recipient
Public Charities, Private Operating Foundations, and Private Distributing Foundations	50%	30% [149]	20%
Nonoperating Private Foundations	30%	20%	20%

[147] Percentages shown are the percentage of an individual's contribution base.

[148] Capital gain property contributed to public charities, private operating foundations, or private distributing foundations will be subject to the 50-percent limitation if the donor elects to reduce the fair market value of the property by the amount that would have been long-term capital gain if the property had been sold.

[149] Certain qualified conservation contributions to public charities (generally, conservation easements), qualify for more generous contribution limits. In general, the 30-percent limit applicable to contributions of capital gain property is increased to 100 percent if the individual making the qualified conservation contribution is a qualified farmer or rancher or to 50 percent if the individual is not a qualified farmer or rancher.

Corporate taxpayers

A corporation generally may deduct charitable contributions up to 10 percent of the corporation's taxable income for the year.[150] For this purpose, taxable income is determined without regard to: (1) the charitable contributions deduction; (2) any net operating loss carryback to the taxable year; (3) deductions for dividends received; (4) deductions for dividends paid on certain preferred stock of public utilities; and (5) any capital loss carryback to the taxable year.[151]

Carryforwards of excess contributions

Charitable contributions that exceed the applicable percentage limit generally may be carried forward for up to five years.[152] In general, contributions carried over from a prior year are taken into account after contributions for the current year that are subject to the same percentage limit. Excess contributions made for the use of (rather than to) an organization generally may not be carried forward.

Qualified conservation contributions

Preferential percentage limits and carryforward rules apply for qualified conservation contributions.[153] In general, the 30-percent contribution base limitation on contributions of capital gain property by individuals does not apply to qualified conservation contributions. Instead, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) (generally, public charities) to the extent of the excess of 50 percent of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions. Individuals are allowed to carry forward any qualified conservation contributions that exceed the 50-percent limitation for up to 15 years. In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100 percent of the excess of the taxpayer's

[150] Sec. 170(b)(2)(A).

[151] Sec. 170(b)(2)(C).

[152] Sec. 170(d).

[153] Sec. 170(b)(1)(E).

contribution base over the amount of all other allowable charitable contributions.

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100 percent of the excess of the corporation's taxable income (as computed under section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100-percent limitation.[154]

A qualified farmer or rancher means a taxpayer whose gross income from the trade or business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

Valuation of charitable contributions

In general

For purposes of the income tax charitable deduction, the value of property contributed to charity may be limited to the fair market value of the property, the donor's tax basis in the property, or in some cases a different amount.

Charitable contributions of cash are deductible in the amount contributed, subject to the percentage limits discussed above. In addition, a taxpayer generally may deduct the full fair market value of long-term capital gain property contributed to charity.[155] Contributions of tangible personal property also generally are deductible at fair market value if the use by the recipient charitable organization is related to its tax-exempt purpose.

In certain other cases, however, section 170(e) limits the deductible value of the contribution of appreciated property to the donor's tax basis in the property. This limitation of the property's deductible value to basis generally applies, for example, for: (1) contributions of inventory or other ordinary income or short-term capital gain property;[156] (2) contributions of tangible personal property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose;[157] and (3) contributions to or for the use of a private foundation (other than certain private operating foundations).[158]

For contributions of qualified appreciated stock, the above-described rule that limits the value of property contributed to or for the use of a private nonoperating foundation to the taxpayer's basis in the property does not apply; therefore, subject to certain limits, contributions of qualified appreciated stock to a nonoperating private foundation may be deducted at fair market value.[159] Qualified appreciated stock is stock that is capital gain property and for which (as of the date of the contribution) market quotations are

[154] Sec. 170(b)(2)(B).

[155] Capital gain property means any capital asset or property used in the taxpayer's trade or business, the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Sec. 170(e)(1)(A).

[156] Sec. 170(e). Special rules, discussed below, apply for certain contributions of inventory and other property.

[157] Sec. 170(e)(1)(B)(i)(I).

[158] Sec. 170(e)(1)(B)(ii). Certain contributions of patents or other intellectual property also generally are limited to the donor's basis in the property. Sec. 170(e)(1)(B)(iii). However, a special rule permits additional charitable deductions beyond the donor's tax basis in certain situations.

[159] Sec. 170(e)(5).

readily available on an established securities market.[160] A contribution of qualified appreciated stock (when increased by the aggregate amount of all prior such contributions by the donor of stock in the corporation) generally does not include a contribution of stock to the extent the amount of the stock contributed exceeds 10 percent (in value) of all of the outstanding stock of the corporation.[161]

Contributions of property with a fair market value that is less than the donor's tax basis generally are deductible at the fair market value of the property.

Enhanced deduction rules for certain contributions of inventory and other property

Although most charitable contributions of property are valued at fair market value or the donor's tax basis in the property, certain statutorily described contributions of appreciated inventory and other property qualify for an enhanced deduction valuation that exceeds the donor's tax basis in the property, but which is less than the fair market value of the property.

As discussed above, a taxpayer's deduction for charitable contributions of inventory property generally is limited to the taxpayer's basis (typically, cost) in the inventory, or if less, the fair market value of the property. For certain contributions of inventory, however, C corporations (but not other taxpayers) may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciation (*i.e.*, basis plus one-half of fair market value in excess of basis) or (2) two times basis.[162] To be eligible for the enhanced deduction value, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements.[163] Contributions to organizations that are not described in section 501(c)(3), such as governmental entities, do not qualify for this enhanced deduction.

To use the enhanced deduction provision, the taxpayer must establish that the fair market value of the donated item exceeds basis.

A taxpayer engaged in a trade or business, whether or not a C corporation, is eligible to claim the enhanced deduction for certain donations of food inventory.[164]

Selected statutory rules for specific types of contributions

Special statutory rules limit the deductible value (and impose enhanced reporting obligations on donors) of charitable contributions of certain types of property, including vehicles, intellectual property, and clothing and household items. Each of these rules was en-

[160] Sec. 170(e)(5)(B).
[161] Sec. 170(e)(5)(C).
[162] Sec. 170(e)(3).
[163] Sec. 170(e)(3)(A)(i)–(iii).
[164] Sec. 170(e)(3)(C).

acted in response to concerns that some taxpayers did not accurately report—and in many instances overstated—the value of the property for purposes of claiming a charitable deduction.

Vehicle donations.—Under present law, the amount of deduction for charitable contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeds $500 and excluding inventory property) depends upon the use of the vehicle by the donee organization. If the donee organization sells the vehicle without any significant intervening use or material improvement of such vehicle by the organization, the amount of the deduction may not exceed the gross proceeds received from the sale. In other situations, a fair market value deduction may be allowed.

Patents and other intellectual property.—If a taxpayer contributes a patent or other intellectual property (other than certain copyrights or inventory)[165] to a charitable organization, the taxpayer's initial charitable deduction is limited to the lesser of the taxpayer's basis in the contributed property or the fair market value of the property.[166] In addition, the taxpayer generally is permitted to deduct, as a charitable contribution, certain additional amounts in the year of contribution or in subsequent taxable years based on a specified percentage of the qualified donee income received or accrued by the charitable donee with respect to the contributed intellectual property. For this purpose, qualified donee income includes net income received or accrued by the donee that properly is allocable to the intellectual property itself (as opposed to the activity in which the intellectual property is used).[167]

Clothing and household items.—Charitable contributions of clothing and household items generally are subject to the charitable deduction rules applicable to tangible personal property. If such contributed property is appreciated property in the hands of the taxpayer, and is not used to further the donee's exempt purpose, the deduction is limited to basis. In most situations, however, clothing and household items have a fair market value that is less than the taxpayer's basis in the property. Because property with a fair market value less than basis generally is deductible at the property's fair market value, taxpayers generally may deduct only the fair market value of most contributions of clothing or household items, regardless of whether the property is used for exempt or unrelated purposes by the donee organization. Furthermore, a special rule generally provides that no deduction is allowed for a charitable contribution of clothing or a household item unless the item is in good used or better condition. The Secretary is authorized to deny by regulation a deduction for any contribution of clothing or a household item that has minimal monetary value, such as used socks and used undergarments. Notwithstanding the general rule, a charitable contribution of clothing or household items not in good used or better condition with a claimed value of more than $500

[165] Under present and prior law, certain copyrights are not considered capital assets, such that the charitable deduction for such copyrights generally is limited to the taxpayer's basis. See sec. 1221(a)(3), 1231(b)(1)(C).

[166] Sec. 170(e)(1)(B)(iii).

[167] The present-law rules allowing additional charitable deductions for qualified donee income were enacted as part of the American Jobs Creation Act of 2004, and are effective for contributions made after June 3, 2004. For a more detailed description of these rules, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress* (JCS–5–05), May 2005, pp. 457–461.

may be deducted if the taxpayer includes with the taxpayer's return a qualified appraisal with respect to the property.[168] Household items include furniture, furnishings, electronics, appliances, linens, and other similar items. Food, paintings, antiques, and other objects of art, jewelry and gems, and certain collections are excluded from the special rules described in the preceding paragraph.[169]

College athletic seating rights.—In general, where a taxpayer receives or expects to receive a substantial return benefit for a payment to charity, the payment is not deductible as a charitable contribution. However, special rules apply to certain payments to institutions of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event. Specifically, the payor may treat 80 percent of a payment as a charitable contribution where: (1) the amount is paid to or for the benefit of an institution of higher education (as defined in section 3304(f)) described in section (b)(1)(A)(ii) (generally, a school with a regular faculty and curriculum and meeting certain other requirements), and (2) such amount would be allowable as a charitable deduction but for the fact that the taxpayer receives (directly or indirectly) as a result of the payment the right to purchase tickets for seating at an athletic event in an athletic stadium of such institution.[170]

Use of a vehicle when volunteering for a charity

Unreimbursed out-of-pocket expenditures made incident to providing donated services to a qualified charitable organization—such as out-of-pocket transportation expenses necessarily incurred in performing donated services—may qualify as a charitable contribution.[171] No charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.[172]

In determining the amount treated as a charitable contribution where a taxpayer operates a vehicle in providing donated services to a charity, the taxpayer either may track and deduct actual out-of-pocket expenditures or, in the case of a passenger automobile, may use the charitable standard mileage rate. The charitable standard mileage rate is set by statute at 14 cents per mile.[173] The taxpayer may also deduct (under either computation method), any parking fees and tolls incurred in rendering the services, but may not deduct any amount (regardless of the computation method used) for general repair or maintenance expenses, depreciation, insurance, registration fees, etc. Regardless of the computation method used, the taxpayer must keep reliable written records of ex-

[168] As is discussed above, the charitable contribution substantiation rules generally require a qualified appraisal where the claimed value of a contribution is more than $5,000.

[169] The special rules concerning the deductibility of clothing and household items were enacted as part of the Pension Protection Act of 2006, P.L. 109–280 (August 17, 2006), and are effective for contributions made after August 17, 2006. For a more detailed description of these rules, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 109th Congress* (JCS–1–07), January 17, 2007, pp. 597–600.

[170] Sec. 170(l).

[171] Treas. Reg. sec. 1.170A–1(g).

[172] Sec. 170(j).

[173] Sec. 170(i).

penses incurred. For example, where a taxpayer uses the charitable standard mileage rate to determine a deduction, the IRS has stated that the taxpayer generally must maintain records of miles driven, time, place (or use), and purpose of the mileage. If the charitable standard mileage rate is not used to determine the deduction, the taxpayer generally must maintain reliable written records of actual expenses incurred.[174]

Substantiation and other formal requirements

In general

A donor who claims a deduction for a charitable contribution must maintain reliable written records regarding the contribution, regardless of the value or amount of such contribution.[175] In the case of a charitable contribution of money, regardless of the amount, applicable recordkeeping requirements are satisfied only if the donor maintains as a record of the contribution a bank record or a written communication from the donee showing the name of the donee organization, the date of the contribution, and the amount of the contribution. In such cases, the recordkeeping requirements may not be satisfied by maintaining other written records.

No charitable contribution deduction is allowed for a separate contribution of $250 or more unless the donor obtains a contemporaneous written acknowledgement of the contribution from the charity indicating whether the charity provided any good or service (and an estimate of the value of any such good or service) to the taxpayer in consideration for the contribution.[176]

In addition, any charity receiving a contribution exceeding $75 made partly as a gift and partly as consideration for goods or services furnished by the charity (a "quid pro quo" contribution) is required to inform the contributor in writing of an estimate of the value of the goods or services furnished by the charity and that only the portion exceeding the value of the goods or services is deductible as a charitable contribution.[177]

If the total charitable deduction claimed for noncash property is more than $500, the taxpayer must attach a completed Form 8283 (Noncash Charitable Contributions) to the taxpayer's return or the deduction is not allowed.[178] In general, taxpayers are required to obtain a qualified appraisal for donated property with a value of more than $5,000, and to attach an appraisal summary to the tax return.

[174] In lieu of actual operating expenses, an optional standard mileage rate may be used in computing deductible transportation expenses for medical purposes (section 213) or for work-related moving (section 217). The standard mileage rates for medical and moving purposes generally cover only out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile. Such rates do not include costs that are not deductible for medical or moving purposes, such as general maintenance expenses, depreciation, insurance, and registration fees. The medical and moving standard mileage rates are determined by the IRS and updated periodically. For expenses paid or incurred on or after January 1, 2017, the rate for both such purposes is 17 cents per mile. IRS Notice 2016–79.

[175] Sec. 170(f)(17).

[176] Such acknowledgement must include the amount of cash and a description (but not value) of any property other than cash contributed, whether the donee provided any goods or services in consideration for the contribution, and a good faith estimate of the value of any such goods or services. Sec. 170(f)(8).

[177] Sec. 6115.

[178] Sec. 170(f)(11).

Exception for certain contributions reported by the donee organization

Subsection 170(f)(8)(D) provides an exception to the contemporaneous written acknowledgment requirement described above. Under the exception, a contemporaneous written acknowledgment is not required if the donee organization files a return, on such form and in accordance with such regulations as the Secretary may prescribe, that includes the same content. "[T]he section 170(f)(8)(D) exception is not available unless and until the Treasury Department and the IRS issue final regulations prescribing the method by which donee reporting may be accomplished." [179] No such final regulations have been issued.[180]

REASONS FOR CHANGE

The Committee believes that a robust charitable sector is vital to our economy, and that charitable giving is critical to ensuring that the sector thrives. For this reason, the Committee believes that it is desirable to provide additional incentives for taxpayers to provide monetary and volunteer support to charities. Increasing the charitable percentage limit for cash contributions to public charities will encourage taxpayers to provide essential monetary support to front-line charities. Allowing the charitable standard mileage rate to be adjusted for inflation will encourage the volunteer support that charities need to carry out their missions. At the same time, the Committee believes that taxpayers should only be permitted a charitable deduction commensurate with the value of assets given to charity. For this reason, the provision eliminates the special rule under present law that allows taxpayers to take a charitable deduction for 80 percent of an amount contributed to a college or university in exchange for the right to purchase stadium seating and denies a deduction for such contribution.

EXPLANATION OF PROVISION

The provision makes the following modifications to the present law charitable deduction rules.

Increased percentage limits for contributions of cash to public charities

The provision increases the income-based percentage limit described in section 170(b)(1)(A) for certain charitable contributions by an individual taxpayer of cash to public charities and certain other organizations from 50 percent to 60 percent.

[179] See IRS, Notice of Proposed Rulemaking, Substantiation Requirement for Certain Contributions, REG–138344–13 (October 13, 2015), I.R.B. 2015–41 (preamble).

[180] In October 2015, the IRS issued proposed regulations that, if finalized, would have implemented the section 170(f)(8)(D) exception to the contemporaneous written acknowledgment requirement. The proposed regulations provided that a return filed by a donee organization under section 170(f)(8)(D) must include, in addition to the information generally required on a contemporaneous written acknowledgment: (1) the name and address of the donee organization; (2) the name and address of the donor; and (3) the taxpayer identification number of the donor. In addition, the return must be filed with the IRS (with a copy provided to the donor) on or before February 28 of the year following the calendar year in which the contribution was made. Under the proposed regulations, donee reporting would have been optional and would have been available solely at the discretion of the donee organization. The proposed regulations were withdrawn in January 2016. See Prop. Treas. Reg. sec 1.170A–13(f)(18).

Charitable mileage rate adjusted for inflation

The provision repeals the statutory charitable mileage rate and provides instead that the standard mileage rate used for determining the charitable contribution deduction shall be a rate which takes into account the variable costs of operating an automobile. The intent of the provision is to allow the IRS to determine, and make periodic adjustments to, the charitable standard mileage rate, taking into account the types of costs that are deductible under section 170 of the Code when operating a vehicle in connection with providing volunteer services (i.e., generally, the out-of-pocket operating expenses (including gasoline and oil) directly related to the use of the automobile for such purposes).

Denial of deduction for college athletic event seating rights

The provision amends section 170(l) to provide that no charitable deduction shall be allowed for any amount described in paragraph 170(l)(2), generally, a payment to an institution of higher education in exchange for which the payor receives the right to purchase tickets or seating at an athletic event, as described in greater detail above.

Repeal of substantiation exception for certain contributions reported by the donee organization

The provision repeals the section 170(f)(8)(D) exception to the contemporaneous written acknowledgment requirement.

EFFECTIVE DATE

The provision is effective for contributions made in taxable years beginning after December 31, 2017.

7. Repeal of deduction for tax preparation expenses (sec. 1307 of the bill and sec. 212 of the Code)

PRESENT LAW

For regular income tax purposes, individuals are allowed an itemized deduction for expenses for the production of income. These expenses are defined as ordinary and necessary expenses paid or incurred in a taxable year: (1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax.[181]

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for tax preparation expenses, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

[181] Sec. 212.

EXPLANATION OF PROVISION

The provision repeals the deduction for expenses in connection with the determination, collection, or refund of any tax.

EFFECTIVE DATE

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

8. Repeal of deduction for medical expenses (sec. 1308 of the bill and sec. 213 of the Code)

PRESENT LAW

Individuals may claim an itemized deduction for unreimbursed medical expenses, but only to the extent that such expenses exceed 10 percent of adjusted gross income.[182] For taxable years beginning before January 1, 2017, the 10-percent threshold is reduced to 7.5 percent in the case of taxpayers who have attained the age of 65 before the close of the taxable year. In the case of married taxpayers, the 7.5 percent threshold applies if either spouse has obtained the age of 65 before the close of the taxable year. For these taxpayers, during these years, the threshold is 10 percent for AMT purposes.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for unreimbursed medical expenses, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision repeals the deduction for unreimbursed medical expenses.

EFFECTIVE DATE

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

9. Repeal of deduction for alimony payments and corresponding inclusion in gross income (sec. 1309 of the bill and secs. 61, 71, and 215 of the Code)

PRESENT LAW

Alimony and separate maintenance payments are deductible by the payor spouse and includible in income by the recipient spouse.[183] Child support payments are not treated as alimony.[184]

[182] Sec. 213. The threshold was amended by the Patient Protection and Affordable Care Act (Pub. L. No. 111–118). For taxable years beginning before January 1, 2013, the threshold was 7.5 percent and 10 percent for alternative minimum tax ("AMT") purposes.

[183] Secs. 215(a), 61(a)(8) and 71(a).

[184] Sec. 71(c).

REASONS FOR CHANGE

The Committee believes that the repeal of the deduction for alimony payments from the payor spouse and repeal of the corresponding inclusion in gross income by the recipient spouse simplifies the tax code and prevents divorced couples from reducing income tax through a specific form of payments unavailable to married couples.

EXPLANATION OF PROVISION

Under the provision, alimony and separate maintenance payments are not deductible by the payor spouse. The provision repeals the Code provisions that specify that alimony and separate maintenance payments are included in income. Thus, the intent of the provision is to follow the rule of the United States Supreme Court's holding in *Gould* v. *Gould,*[185] in which the Court held that such payments are not income to the recipient. Income used for alimony payments is taxed at the rates applicable to the payor spouse rather than the recipient spouse. The treatment of child support is not changed.

EFFECTIVE DATE

The provision is effective for any divorce or separation instrument executed after December 31, 2017, or for any divorce or separation instrument executed on or before December 31, 2017, and modified after that date, if the modification expressly provides that the amendments made by this section apply to such modification.

10. Repeal of deduction for moving expenses (sec. 1310 of the bill and secs. 134 and 217 of the Code)

PRESENT LAW

Individuals are permitted an above-the-line deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.[186] Such expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

Special rules apply in the case of a member of the Armed Forces of the United States. In the case of any such individual who is on active duty, who moves pursuant to a military order and incident to a permanent change of station, the limitations related to distance from the taxpayer's previous residence and status as a full-time employee in the new location do not apply.[187] Additionally, any moving and storage expenses which are furnished in kind to such an individual, spouse, or dependents, or if such expenses are reimbursed or an allowance for such expenses is provided, such amounts are excluded from gross income.[188] Rules also apply to exclude amounts furnished to the spouse and dependents of such an

[185] 245 U.S. 151 (1917).
[186] Sec. 217(a).
[187] Sec. 217(g).
[188] Sec. 217(g)(2).

individual in the event that such individuals move to a location other than to where the member of the Armed Forces is moving.

Present law provides income exclusions for various benefits provided to members of the Armed Forces.[189]

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for moving expenses, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

However, the Committee recognizes that special circumstances apply to members of the Armed Forces, and thus the provision retains the present law benefits relating to the moving expenses of these taxpayers.

EXPLANATION OF PROVISION

The provision generally repeals the deduction for moving expenses. The provision intends to retain tax benefits for the moving expenses of members of the Armed Forces of the United States.[190] Thus, the provision retains the special rules under present law that provide a exclusions for amounts attributable to in-kind moving and storage expenses (and reimbursements or allowances for these expenses) for members of the Armed Forces (or their spouse or dependents) on active duty that move pursuant to a military order and incident to a permanent change of station.[191]

EFFECTIVE DATE

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

11. Termination of deduction and exclusions for contributions to medical savings accounts (sec. 1311 of the bill and secs. 106(b) and 220 of the Code)

PRESENT LAW

Archer MSAs

As of 1997, certain individuals are permitted to contribute to an Archer MSA, which is a tax-exempt trust or custodial account.[192] Within limits, contributions to an Archer MSA are deductible in determining adjusted gross income if made by an individual and are excludible from gross income for income tax purposes and wages for employment tax[193] purposes if made by the employer of an individual.[194]

An individual is generally eligible for an Archer MSA if the individual is covered by a high deductible health plan and no other health plan other than a plan that provides certain permitted in-

[189] Sec. 134.
[190] A technical amendment may be needed to reflect this intent for the deduction for moving expenses for members of the Armed Forces.
[191] Under the provision, these exclusions are added to section 134.
[192] Archer MSAs were originally called medical savings accounts or MSAs.
[193] The FICA exclusion is provided under IRS Notice 96–53.
[194] Secs. 106(b) and 220.

surance or permitted coverage. In addition, the individual either must be an employee of a small employer (generally an employer with 50 or fewer employees on average) that provides the high deductible health plan or must be self-employed or the spouse of a self-employed individual and the high deductible health plan is not provided by the employer of the individual or spouse.

For 2017, a high deductible health plan for purposes of Archer MSA eligibility is a health plan with an annual deductible of at least $2,250 and not more than $3,350 in the case of self-only coverage and at least $4,500 and not more than $6,750 in the case of family coverage. In addition, for 2017, the maximum out-of-pocket expenses with respect to allowed costs must be no more than $4,500 in the case of self-only coverage and no more than $8,250 in the case of family coverage. Out-of-pocket expenses include deductibles, co-payments, and other amounts (other than premiums) that the individual must pay for covered benefits under the plan. A plan does not fail to qualify as a high deductible health plan if substantially all of the coverage under the plan is certain permitted insurance or is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care.

The maximum annual contribution that can be made to an Archer MSA for a year is 65 percent of the annual deductible under the individual's high deductible health plan in the case of self-only coverage (65 percent of $3,350 for 2017) and 75 percent of the annual deductible in the case of family coverage (75 percent of $6,750 for 2017), but in no case more than the individual's compensation income. In addition, the maximum contribution can be made only if the individual is covered by the high deductible health plan for the full year.

Distributions from an Archer MSA for qualified medical expenses are not includible in gross income. Distributions not used for qualified medical expenses are includible in gross income and subject to an additional 20-percent tax unless an exception applies. A distribution from an Archer MSA may be rolled over on a nontaxable basis to another Archer MSA or to a health savings account and does not count against the contribution limits.

After 2007, no new contributions can be made to Archer MSAs except by or on behalf of individuals who previously had made Archer MSA contributions and employees of small employers that previously contributed to Archer MSAs (or at least 20 percent of whose employees who were previously eligible to contribute to Archer MSAs did so).

Health savings accounts

As of 2004, an individual with a high deductible health plan (and no other health plan other than a plan that provides certain permitted insurance or permitted coverage) generally may contribute to a health savings account ("HSA"), which is a tax-exempt trust or custodial account. HSAs provide similar tax-favored savings treatment as Archer MSAs. That is, within limits, contributions to an HSA are deductible in determining adjusted gross income if made by an individual and are excludable from gross income for income tax purposes and wages for employment tax[195] purposes if made by the employer of an individual, and distributions for qualified medical expenses are not includible in gross income.[196] However, the rules for HSAs are in various aspects more favorable than the rules for Archer MSAs.[197] For example, the availability of HSAs is not limited to employees of small employers or self-employed individuals and their spouses.

For 2017, a high deductible health plan for purposes of HSA eligibility is a health plan with an annual deductible of at least $1,300 in the case of self-only coverage and at least $2,600 in the case of family coverage. In addition, for 2017, the sum of the deductible and the maximum out-of-pocket expenses with respect to allowed costs must be no more than $6,550 in the case of self-only coverage and no more than $13,100 in the case of family coverage. A plan does not fail to qualify as a high deductible health plan for HSA purposes merely because it does not have a deductible for preventive care.

For 2017, the maximum aggregate annual contribution that can be made to an HSA is $3,400 in the case of self-only coverage and $6,750 in the case of family coverage. The annual contribution limits are increased by $1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as "catch-up contributions"). The maximum amount that an individual make contribute is reduced by the amount of any contributions to the individual's Archer MSA and any excludable HSA contributions made by the individual's employer. In some cases, an individual may make the maximum HSA contribution, even if the individual is covered by the high deductible health plan for only part of the year. A distribution from an HSA may be rolled over on a nontaxable basis to another HSA and does not count against the contribution limits.

REASONS FOR CHANGE

The Committee recognizes that Archer MSAs provide fewer benefits than HSAs. The termination of the deduction and exclusions for contributions to Archer MSAs therefore simplifies the Code by consolidating two similar tax-favored accounts into a single account with more favorable benefits for the taxpayer (*i.e.*, HSAs).

EXPLANATION OF PROVISION

Under the provision, contributions to Archer MSAs for taxable years beginning after December 31, 2017, are not deductible or excludible from gross income and wages.[198]

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[195] The FICA exclusion is provided under IRS Notice 2004–2.

[196] Secs. 106(d) and 223.

[197] Sections 4980E and 4980G respectively require an employer making MSA or HSA contributions to make comparable contributions for comparable participating employees. However, under section 4980G(d), an employer may make larger HSA contributions for nonhighly compensated employees.

[198] The provision retains the requirement that an employer making HSA contributions must make comparable contributions for comparable participating employees, including the rule under which an employer may make larger HSA contributions for nonhighly compensated employees. As under present law, with respect to highly compensated employees, both highly compensated employees and nonhighly compensated employees are to be treated as comparable participating employees. (A technical amendment is needed to the reference within new section 4980G(d)(3)(B) to subparagraph (B), which should be a reference to subparagraph (A)(ii).)

EFFECTIVE DATE

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

12. Denial of deduction for expenses attributable to the trade or business of being an employee, expenses of teachers, performing artists and certain officials (sec. 1312 of the bill and secs. 62, 67, and new sec. 262A of the Code)

PRESENT LAW

In general, business expenses incurred by an employee are deductible, but only as an itemized deduction and only to the extent the expenses exceed two percent of adjusted gross income.[199] However, in the case of certain employees and certain expenses, a deduction may be taken in determining adjusted gross income (referred to as an "above-the-line" deduction), including expenses of qualified performing artists, expenses of State or local government officials performing services on a fee basis, and expenses of eligible educators.[200]

Present law and IRS guidance provide for numerous items that may be deducted under this provision (subject to the two-percent adjusted gross income floor). This non-exhaustive list includes):[201]

- Business bad debt of an employee;
- Business liability insurance premiums;
- Damages paid to a former employer for breach of an employment contract;
- Depreciation on a computer a taxpayer's employer requires him to use in his work;
- Dues to a chamber of commerce if membership helps the taxpayer do his job;
- Dues to professional societies;
- Educator expenses;[202]
- Home office or part of a taxpayer's home used regularly and exclusively in the taxpayer's work;
- Job search expenses in the taxpayer's present occupation;
- Laboratory breakage fees;
- Legal fees related to the taxpayer's job;
- Licenses and regulatory fees;
- Malpractice insurance premiums;
- Medical examinations required by an employer;
- Occupational taxes;
- Passport for a business trip;
- Repayment of an income aid payment received under an employer's plan;
- Research expenses of a college professor;
- Rural mail carriers' vehicle expenses;
- Subscriptions to professional journals and trade magazines related to the taxpayer's work;
- Tools and supplies used in the taxpayer's work;

[199] Secs. 62(a)(1) and 67.

[200] Sec. 62(a)(2)(B), (C), and (D). Under section 62(a)(2)(A) and (c), certain reimbursements of employee business expenses are excluded from income. Under section 62(a)(2)(E), an above-the-line deduction applies to expenses of members of a reserve component of the Armed Forces.

[201] See IRS Publication 529, "*Miscellaneous Deductions*" (2016), p. 3.

[202] Under a special provision, these expenses are deductible "above the line" up to $250.

- Travel, transportation, meals, entertainment, gifts, and local lodging related to the taxpayer's work;
- Union dues and expenses;
- Work clothes and uniforms if required and not suitable for everyday use; and
- Work-related education.

A working condition fringe provided to an employee is excluded from the employee's income and wages.[203] For this purpose, a working condition fringe means property or services provided to an employee to the extent that, if the employee paid for the property or service, the payment would be deductible as a business expense or depreciation.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for expenses attributable to the trade or business of being an employee, and expenses of teachers, performing artists, and certain officials, makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

Under the provision, business expenses incurred by an employee are not deductible, other than expenses that are deductible in determining adjusted gross income (that is, above-the-line deductions).

In addition, the present-law provisions allowing above-the-line deductions for expenses of qualified performing artists and expenses of State or local government officials performing services on a fee basis are repealed. The present-law provision allowing an above-the-line deduction for expenses of eligible educators is also repealed.[204]

In addition, whether property or services provided by an employer are excluded as a working condition fringe is determined without regard to the provision. That is, the same standard as under present law applies for this purpose.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

[203] Sec. 132(a)(3) and (d).

[204] The provision retains the present-law provisions under which certain reimbursements of employee business expenses are excluded from income and under which an above-the-line deduction applies to expenses of members of a reserve component of the Armed Forces.

E. Simplification and Reform of Exclusions and Taxable Compensation

1. Limitation on exclusion for employer-provided housing (sec. 1401 of the bill and sec. 119 of the Code)

PRESENT LAW

The value of lodging furnished to an employee, spouse, or dependents by or on behalf of an employer for the convenience of the employer (referred to as "employer-provided lodging") is excludible from the employee's gross income, but only if the employee is required to accept the lodging on the business premises of the employer as a condition of employment.[205] Special rules apply with respect to employees living in foreign camps[206] and lodging furnished by certain educational institutions to employees.[207] Amounts attributable to employer-provided lodging that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

REASONS FOR CHANGE

The Committee believes that limiting the exclusion for employer-provided housing broadens the tax base, closes loopholes, and allows for lower tax rates. The Committee further believes that limiting the exclusion accomplishes these goals without placing undue burden on lower income taxpayers, achieving simplicity and fairness for all individuals and families.

EXPLANATION OF PROVISION

The provision limits the amount that may be excluded from gross income for employer-provided lodging to $50,000 ($25,000 in the case of a married individual filing a separate return), subject to a phase-out based on the employee's level of compensation. The exclusion is phased out by $1 for every $2 earned above the indexed compensation threshold. For 2017, this compensation threshold is $120,000.[208] The provision also denies any exclusion for employer-provided housing provided to 5% owners,[209] regardless of their compensation level.

In addition, the exclusion does not apply to more than one residence at any given time. In the case of spouses filing a joint return, the one residence limit may be applied separately to each spouse for a period during which the spouses reside in separate residences provided in connection with their respective employments.

Those amounts that are not excludible from gross income for income tax purposes will also not be excluded from wages for employment tax purposes.

EFFECTIVE DATE

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

[205] Sec. 119(a).
[206] Sec. 119(c).
[207] Sec. 119(d).
[208] The compensation threshold is that amount in effect under section 414(q)(1)(B)(i).
[209] As defined in section 416(i)(1)(B)(i).

2. Modification of exclusion of gain on sale of a principal residence (sec. 1402 of the bill and sec. 121 of the Code)

PRESENT LAW

A taxpayer who is an individual may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for at least two of the five years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances, is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the two years that the ownership and use requirements are met.

The exclusion under this provision may not be claimed for more than one sale or exchange during any two-year period.

REASONS FOR CHANGE

The Committee believes that the exclusion on proceeds from the sale of a principal residence is intended to prevent longtime homeowners from recognizing a gain upon an infrequent and important transaction, and to allow those individuals to use the full proceeds of the home sale to purchase another home. The Committee believes that present-law the rule allowing individuals to live in their home for only two out of the prior five years to qualify for the exclusion has allowed individuals to cycle between building homes and living in those homes while they build the next, selling the lived-in home and qualifying for the exclusion on the proceeds. Such use takes advantage of the exclusion in a manner that was not intended.

The Committee further believes that high income taxpayers should not be eligible for the exclusion.

EXPLANATION OF PROVISION

The provision extends the length of time a taxpayer must own and use a residence to qualify for this exclusion. Specifically, the exclusion is available only if the taxpayer has owned and used the residence as a principal residence for at least five of the eight years ending on the date of the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) that is equal to the fraction of the five years that the ownership and use requirements are met.

The provision limits the exclusion so that the exclusion may not apply to more than one sale or exchange during any five-year period.

The provision phases-out the exclusion by one dollar for every dollar a taxpayer's AGI exceeds $250,000 ($500,000 if married filing a joint return). For purposes of this provision, AGI is measured using the average of the taxpayer's AGI in the year of sale (excluding any income from the sale of the home) and the prior two taxable years before the sale.

EFFECTIVE DATE

The provision is effective for sales and exchanges after December 31, 2017.

3. Repeal of exclusion, etc., for employee achievement awards (sec. 1403 of the bill and secs. 74(c) and 274(j) of the Code)

PRESENT LAW

An employer's deduction for the cost of an employee achievement award is limited to a certain amount.[210] Employee achievement awards that are deductible by an employer (or would be deductible but for the fact that the employer is a tax-exempt organization) are excludible from an employee's gross income.[211] Amounts that are excludible from gross income under section 74(c) for income tax purposes are also excluded from wages for employment tax purposes.

An employee achievement award is an item of tangible personal property given to an employee in recognition of either length of service or safety achievement and presented as part of a meaningful presentation.

REASONS FOR CHANGE

The Committee believes that the repeal of the deduction limitation and exclusions for employee achievement awards makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that the repeal of this provision is part of its larger effort toward tax reform which broadens the tax base, closes loopholes, and grows the economy.

EXPLANATION OF PROVISION

The provision repeals the deduction limitation for employee achievement awards. It also repeals the exclusions from gross income and wages.

EFFECTIVE DATE

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

4. Sunset of exclusion for dependent care assistance programs (sec. 1404 of the bill and sec. 129 of the Code)

PRESENT LAW

An exclusion from the gross income of an employee of up to $5,000 annually for employer-provided dependent care assistance[212] is allowed if the assistance is provided pursuant to a separate written plan of an employer that does not discriminate in

[210] Sec. 274(j).
[211] Sec. 74(c).
[212] Sec. 129(a).

favor of highly compensated employees[213] and meets certain other requirements. The amount excludible cannot exceed the earned income of the employee or, if the employee is married, the lesser of the earned income of the employee or the earned income of the employee's spouse. Amounts attributable to dependent care assistance that are excludible from gross income for income tax purposes are also excludible from wages for employment tax purposes.

REASONS FOR CHANGE

The Committee believes that the sunset of the exclusion for dependent care assistance programs makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that repeal of this provision is consistent with streamlining the tax code, broadening the tax base, lowering rates, and growing the economy.

EXPLANATION OF PROVISION

The provision terminates the exclusions from gross income and wages for dependent care assistance programs for taxable years beginning after December 31, 2022.

EFFECTIVE DATE

The provision is effective on the date of enactment.

5. Repeal of exclusion for qualified moving expense reimbursement (sec. 1405 of the bill and sec. 132(g) of the Code)

PRESENT LAW

Qualified moving expense reimbursements are excludible from an employee's gross income[214], and are defined as any amount received (directly or indirectly) from an employer as payment for (or reimbursement of) expenses which would be deductible as moving expenses under section 217[215] if directly paid or incurred by the employee. However, any such amount actually deducted by the individual is not eligible for this exclusion. Amounts excludible from gross income for income tax purposes as qualified moving expense reimbursements are also excluded from wages for employment tax purposes.

REASONS FOR CHANGE

The Committee believes that the repeal of the exclusion for qualified moving expense reimbursement makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that the repeal of this provi-

[213] Section 129(d). The exclusion applies if the contributions or benefits under the program do not discriminate in favor of highly compensated employees, within the meaning of Sec. 414(q), or their dependents, and the program benefits employees under a classification established by the employer found not to be discriminatory in favor or such highly compensated employees or their dependents.

[214] Section 132(a)(6) and 132(g).

[215] Individuals are allowed an itemized deduction for moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work. Such expenses are deductible only if the move meets certain conditions related to distance from the taxpayer's previous residence and the taxpayer's status as a full-time employee in the new location.

sion is part of its larger effort toward tax reform which broadens the tax base, closes loopholes and grows the economy.

EXPLANATION OF PROVISION

The provision repeals the exclusion from gross income and wages for qualified moving expense reimbursements.

EFFECTIVE DATE

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

6. Repeal of exclusion for adoption assistance programs (sec. 1406 of the bill and sec. 137 of the Code)

PRESENT LAW

An exclusion from an employee's gross income is allowed for qualified adoption expenses paid or reimbursed by an employer, if such amounts are furnished pursuant to an adoption assistance program.[216] For 2017, the maximum exclusion amount is $13,570, and is phased out ratably for taxpayers with modified adjusted gross income ("AGI") above a certain amount. In 2017, the phase out range begins at modified AGI of $203,540, with no exclusion when modified AGI equals or exceeds $243,540. Modified AGI is the sum of the taxpayer's AGI plus amounts excluded from income under sections 911, 931, and 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands and residents of Puerto Rico, respectively).

In the case of adoption of a child with special needs that is finalized during a taxable year, the taxpayer may claim as an exclusion the amount of the maximum exclusion minus the aggregate qualified adoption expenses with respect to that adoption for all prior taxable years.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorney fees, and other expenses that are: (1) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (2) not incurred in violation of State or Federal law, or in carrying out any surrogate parenting arrangement; (3) not for the adoption of the child of the taxpayer's spouse; and (4) not reimbursed (e.g., by an employer).[217]

For the exclusion to apply, certain requirements must be satisfied, including satisfaction of nondiscrimination rules and providing employees with reasonable notification of the availability and terms of the program.[218]

Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit under section 23. A taxpayer may be eligible for the adoption credit

[216] Section 137(a).
[217] Section 23(d)(1).
[218] The employer's adoption assistance program must not discriminate in favor of highly compensated employees, within the meaning of Sec. 414(q). In addition, no more than five percent of the amounts paid or incurred by the employer during the year for qualified adoption expenses under an adoption assistance program can be provided for the class of individuals consisting of more-than-five-percent owners of the employer and the spouses or dependents of such more-than-five-percent owners.

(with respect to qualified adoption expenses he or she incurs) and also for the exclusion (with respect to different qualified adoption expenses paid or reimbursed by his or her employer).

REASONS FOR CHANGE

The Committee believes that the repeal of the exclusion for adoption assistance programs makes the system simpler and fairer for all families and individuals, and allows for lower tax rates. The Committee further believes that the repeal of this provision is part of its larger effort toward tax reform which broadens the tax base, closes loopholes and grows the economy.

EXPLANATION OF PROVISION

The provision repeals the exclusion from gross income for adoption assistance programs.

EFFECTIVE DATE

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

F. SIMPLIFICATION AND REFORM OF SAVINGS, PENSIONS, RETIREMENT

1. Repeal of special rule permitting recharacterization of IRA contributions (sec. 1501 of the bill and sec. 408A of the Code)

PRESENT LAW

Individual retirement arrangements

There are two basic types of individual retirement arrangements ("IRAs") under present law: traditional IRAs,[219] to which both deductible and nondeductible contributions may be made,[220] and Roth IRAs, to which only nondeductible contributions may be made.[221] The principal difference between these two types of IRAs is the timing of income tax inclusion.

An annual limit applies to contributions to IRAs. The contribution limit is coordinated so that the aggregate maximum amount that can be contributed to all of an individual's IRAs (both traditional and Roth) for a taxable year is the lesser of a certain dollar amount ($5,500 for 2017) or the individual's compensation. In the case of a married couple, contributions can be made up to the dollar limit for each spouse if the combined compensation of the spouses is at least equal to the contributed amount. The dollar limit is increased annually ("indexed") as needed to reflect increases in the cost-of living. An individual who has attained age 50 before the end of the taxable year may also make catch-up contributions up to $1,000 to an IRA. The IRA catch-up contribution limit is not indexed.

Traditional IRAs

An individual may make deductible contributions to a traditional IRA up to the IRA contribution limit (reduced by any contributions

[219] Sec. 408.
[220] Secs. 219(a) and 408(o).
[221] Sec. 408A.

to Roth IRAs) if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with adjusted gross income ("AGI") for the taxable year over certain indexed levels.[222] To the extent an individual cannot or does not make deductible contributions to a traditional IRA or contributions to a Roth IRA for the taxable year, the individual may make nondeductible after-tax contributions to a traditional IRA (that is, no AGI limits apply), subject to the same contribution limits as the limits on deductible contributions, including catch-up contributions. An individual who has attained age 70½ before to the close of a year is not permitted to make contributions to a traditional IRA for that year.

Amounts held in a traditional IRA are includible in income when withdrawn, except to the extent the withdrawal is a return of the individual's basis.[223] All traditional IRAs of an individual are treated as a single contract for purposes of recovering basis in the IRAs.

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that can be made to a Roth IRA is phased out for taxpayers with AGI for the taxable year over certain indexed levels.[224]

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income. A qualified distribution is a distribution that (1) is made after the five-taxable-year period beginning with the first taxable year for which the individual first made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings; amounts that are attributable to a return of contributions to the Roth IRA are not includible in income. All Roth IRAs are treated as a single contract for purposes of determining the amount that is a return of contributions.

Separation of traditional and Roth IRA accounts

Contributions to traditional IRAs and to Roth IRAs must be segregated into separate IRAs, meaning arrangements with separate trusts, accounts, or contracts, and separate IRA documents. Except in the case of a conversion or recharacterization, amounts cannot be transferred or rolled over between the two types of IRAs.

Taxpayers generally may convert an amount in a traditional IRA to a Roth IRA.[225] The amount converted is includible in the tax-

[222] Sec. 219(g).

[223] Basis results from after-tax contributions to traditional IRAs or a rollovers to traditional IRAs of after-tax amounts from another eligible retirement plan.

[224] Although an individual with AGI exceeding certain limits is not permitted to make a contribution directly to a Roth IRA, the individual can make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA, as discussed below.

[225] Although an individual with AGI exceeding certain limits is not permitted to make a contribution directly to a Roth IRA, the individual can make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA.

payer's income as if a withdrawal had been made.[226] The conversion is accomplished by a trustee-to-trustee transfer of the amount from the traditional IRA to the Roth IRA, or by a distribution from the traditional IRA and contribution to the Roth IRA within 60 days.

Rollovers to IRAs of distributions from tax-favored employer-sponsored retirement plans (that is, qualified retirement plans, tax-deferred annuity plans, and governmental eligible deferred compensation plans[227]) are also permitted. For tax-free rollovers, distributions from pretax accounts under an employer-sponsored plan generally must are contributed to a traditional IRA, and distributions from a designated Roth account under an employer-sponsored plan must be contributed only to a Roth IRA. However, a distribution from an employer-sponsored plan that is not from a designated Roth account is also permitted to be rolled over into a Roth IRA, subject to the rules that apply to conversions from a traditional IRA into a Roth IRA. Thus, a rollover from a tax-favored employer-sponsored plan to a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions).[228]

Recharacterization of IRA contributions

If an individual makes a contribution to an IRA (traditional or Roth) for a taxable year, the individual is permitted to recharacterize the contribution as a contribution to the other type of IRA (traditional or Roth) by making a trustee-to-trustee transfer to the other type of IRA before the due date for the individual's income tax return for that year.[229] In the case of a recharacterization, the contribution will be treated as having been made to the transferee IRA (and not the original, transferor IRA) as of the date of the original contribution. Both regular contributions and conversion contributions to a Roth IRA can be recharacterized as having been made to a traditional IRA.

The amount transferred in a recharacterization must be accompanied by any net income allocable to the contribution. In general, even if a recharacterization is accomplished by transferring a specific asset, net income is calculated as a pro rata portion of income on the entire account rather than income allocable to the specific asset transferred. However, when doing a Roth conversion of an amount for a year, an individual may establish multiple Roth IRAs, for example, Roth IRAs with different investment strategies, and divide the amount being converted among the IRAs. The individual can then choose whether to recharacterize any of the Roth IRAs as a traditional IRA by transferring the entire amount in the particular Roth IRA to a traditional IRA.[230] For example, if the value of the assets in a particular Roth IRA declines after the conversion, the conversion can be reversed by recharacterizing that IRA as a

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[226] Subject to various exceptions, distributions from an IRA before age 59½ that are includible in income are subject to a 10-percent early distribution tax under section 72(t). An exception applies to an amount includible in income as a result of the conversion from a traditional IRA into a Roth IRA. However, the early distribution tax applies if the taxpayer withdraws the amount within five years of the conversion.

[227] Secs. 401(a), 403(a), 403(b) and 457(b).

[228] As in the case of a conversion of an amount from a traditional IRA to a Roth IRA, the special recapture rule relating to the 10-percent additional tax on early distributions applies for distributions made from the Roth IRA within a specified five-year period after the rollover.

[229] Sec. 408A(d)(6).

[230] Treas. Reg. sec. 1.408A–5, Q&A–2(b).

traditional IRA. The individual may then later convert that traditional IRA to a Roth IRA (referred to as a reconversion), including only the lower value in income. Treasury regulations prevent the reconversion from taking place immediately after the recharcterization, by requiring a minimum period to elapse before the reconversion. Generally the reconversion cannot occur sooner than the later of 30 days after the recharacterization or a date during the taxable year following the taxable year of the original conversion.[231]

REASONS FOR CHANGE

Recharacterization of IRA contributions may enable an individual to avoid tax by retroactively manipulating the amount of income that must be recognized for tax purposes. The Committee intends to repeal the recharacterization rule in order to prevent such manipulation.

EXPLANATION OF PROVISION

The provision repeals the special rule that allows IRA contributions to one type of IRA (either traditional or Roth) to be recharacterized as a contribution to the other type of IRA. Thus, for example, under the provision, a conversion contribution establishing a Roth IRA during a taxable year can no longer be recharacterized as a contribution to a traditional IRA (thereby unwinding the conversion).[232]

EFFECTIVE DATE

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

2. Reduction in minimum age for allowable in-service distributions (sec. 1502 of the bill and secs. 401 and 457 of the Code)

PRESENT LAW

Tax-favored employer-sponsored retirement plans consist of qualified retirement plans, including certain defined contribution plans that allow employees to make elective deferrals (a "section 401(k) plan"), tax-deferred annuity plans (a "section 403(b) plan"), which may also allow employees to make elective deferrals, and eligible deferred compensation plans of State and local government employers (a "governmental section 457(b) plan").[233] The terms of an employer-sponsored retirement plan generally determine when distributions are permitted. However, in some cases, restrictions may apply to distribution before an employee's severance from employment, referred to as "in-service" distributions.

In-service distributions of elective deferrals (and related earnings) under a section 401(k) plan generally are permitted only after attainment of age 59½ or termination of the plan.[234] In-service dis-

[231] Treas. Reg. sec. 1.408A–5, Q&A–9.

[232] The provision does not preclude an individual from making a contribution to a traditional IRA and converting the traditional IRA to a Roth IRA. Rather, the provision would preclude the individual from later unwinding the conversion through a recharacterization.

[233] Secs. 401(a), 401(k), 403(a), 403(b), and 457(b).

[234] Sec. 401(k)(2)(B). Similar restrictions apply to certain other contributions, such as employer matching or nonelective contributions required under the nondiscrimination safe harbors under section 401(k).

tributions of elective deferrals (but not related earnings) are also permitted in the case of hardship. Elective deferrals under a section 403(b) plan are subject to in-service distribution restrictions similar to those applicable to elective deferrals under a section 401(k) plan, and, in some cases, other contributions to a section 403(b) plan are subject to similar restrictions.[235]

Pension plans, that is, qualified defined benefit plans and money purchase pension plans, a type of qualified defined contribution plan, generally may not permit in-service distributions before attainment of age 62 (or attainment of normal retirement age under the plan if earlier) or termination of the plan.[236]

Deferrals under a governmental section 457(b) plan are subject to in-service distribution restrictions similar to those applicable to elective deferrals under a section 401(k) plan, except that in-service distributions under a governmental section 457(b) plan are permitted only after attainment of age 70½ (rather than age 59½).[237]

REASONS FOR CHANGE

Present law offers various types of tax-favored employer-sponsored retirement plans that are very similar, but with minor variations such as the age at which in-service distributions are permitted. These variations create complexity for employers and plan administrators and may cause confusion for employees. These variations also impose different rules on generally similarly situated taxpayers instead of providing the same rules for all taxpayers. Providing a uniform age for allowable in-service distributions will help simplify the rules for various types of plans. In addition, lowering the age to 59½ for all plans will remove a tax barrier to phased retirement as an alternative to early retirement.

EXPLANATION OF PROVISION

Under the provision, in-service distributions are permitted under a pension plan or a governmental section 457(b) plan at age 59½, thus making the rules for those plans consistent with the rules for section 401(k) plans and section 403(b) plans.

EFFECTIVE DATE

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

3. Modification of rules governing hardship distributions (sec. 1503 of the bill and secs. 401 and 403 of the Code)

PRESENT LAW

Elective deferrals under a section 401(k) plan or a section 403(b) plan may not be distributed before the occurrence of one or more specified events, including financial hardship of the employee.[238]

Applicable Treasury regulations provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee

[235] Secs. 403(b)(7)(A)(ii) and 403(b)(11).
[236] Sec. 401(a)(36) and Treas. Reg. secs. 1.401–1(b)(1)(i) and 1.401(a)–1(b).
[237] Sec. 457(d)(1)(A).
[238] Secs. 401(k)(2)(B)(i)(IV) and 403(b)(7)(A)(ii) and (b)(11)(B). Other types of contributions may also be subject to this restriction.

and is necessary to satisfy the heavy need.[239] The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making elective deferrals and employee contributions to the plan and all other plans maintained by the employer for at least six months after receipt of the hardship distribution.

REASONS FOR CHANGE

The rules relating to hardship distributions contain minor distinctions that create complexity for employers and plan administrators. These distinctions may lead to inadvertent errors, correction of which increases plan costs, and may also cause confusion for employees. In addition, the rule prohibiting employees from making contributions for six months after receiving a hardship distribution impedes employees' ability to save for retirement. The Committee believes that the rules relating to hardship withdrawals should be more consistent and should not impede retirement savings.

EXPLANATION OF PROVISION

The Secretary of the Treasury is directed to modify the applicable regulations within one year of the date of enactment to (1) delete the requirement that an employee be prohibited from making elective deferrals and employee contributions for six months after the receipt of a hardship distribution in order for the distribution to be deemed necessary to satisfy an immediate and heavy financial need, and (2) make any other modifications necessary to carry out the purposes of the rule allowing elective deferrals to be distributed in the case of hardship. Thus, under the modified regulations, an employee would not be prevented for any period after the receipt of a hardship distribution from continuing to make elective deferrals and employee contributions.

EFFECTIVE DATE

The regulations as revised by the provision shall apply to plan years beginning after December 31, 2017.

4. Modification of rules relating to hardship withdrawals from cash or deferred arrangements (sec. 1504 of the bill and sec. 401 of the Code)

PRESENT LAW

Amounts attributable to elective deferrals (including earnings thereon) under a section 401(k) plan generally may not be distributed before the earliest of the employee's severance from employment, death, disability or attainment of age 59½, or termination of the plan, or as a qualified reservist distribution.[240] Elective deferrals, but not associated earnings, may be distributed on account of hardship.

An employer may make nonelective and matching contributions for employees under a section 401(k) plan. Elective deferrals, and matching contributions and after-tax employee contributions, are

[239] Treas. Reg. sec. 1.401(k)–1(d)(3).
[240] Sec. 401(k)(2)(B)(i).

subject to special tests ("nondiscrimination tests") to prevent discrimination in favor of highly compensated employees. Nonelective contributions and matching contributions that satisfy certain requirements ("qualified nonelective contributions and qualified matching contributions") may be used to enable the plan to satisfy these nondiscrimination tests. One of the requirements is that these contributions be subject to the same distribution restrictions as elective deferrals, except that these contributions (and associated earnings) are not permitted to be distributed on account of hardship.

Applicable Treasury regulations provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.[241] The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of the safe harbor is that the employee represent that the need cannot be satisfied through currently available plan loans. This in effect requires an employee to take any available plan loan before receiving a hardship distribution.

REASONS FOR CHANGE

The rules for determining which amounts may be distributed as hardship distributions are overly complex. This complexity may lead to inadvertent errors, correction of which increases plan costs, and may also cause confusion for employees. The Committee wishes to provide more consistency in these rules, thereby reducing complexity.

Plan loans serve a valid purpose in providing employees with temporary use of retirement funds without depleting retirement savings. However, in some cases, a loan may not be suitable to cover an employee's financial need. In that case, a requirement to document the need for a distribution, rather than a loan, creates an unnecessary burden for the employee and plan administrator and may cause a delay that aggravates the employee's financial hardship. The Committee wishes to reduce administrative complexity by removing the requirement to obtain a loan before a hardship distribution. In addition the Committee believes that hardship distributions should not be limited to amounts contributed by the employee.

EXPLANATION OF PROVISION

The provision allows earnings on elective deferrals under a section 401(k) plan, as well as qualified nonelective contributions and qualified matching contributions (and associated earnings), to be distributed on account of hardship. Further, a distribution is not treated as failing to be on account of hardship solely because the employee does not take any available plan loan.

EFFECTIVE DATE

The provision applies to plan years beginning after December 31, 2017.

[241] Treas. Reg. sec. 1.401(k)–1(d)(3).

5. Extended rollover period for the rollover of plan loan offset amounts in certain cases (sec. 1505 of the bill and sec. 402 of the Code)

PRESENT LAW

Taxation of retirement plan distributions

A distribution from a tax-favored employer-sponsored retirement plan (that is, a qualified retirement plan, section 403(b) plan, or a governmental section 457(b) plan) is generally includible in gross income, except in the case of a qualified distribution from a designated Roth account or to the extent the distribution is a recovery of basis under the plan or the distribution is contributed to another such plan or an IRA (referred to as eligible retirement plans) in a tax-free rollover.[242] In the case of a distribution from a retirement plan to an employee under age 59½, the distribution (other than a distribution from a governmental section 457(b) plan) is also subject to a 10-percent early distribution tax unless an exception applies.[243]

A distribution from a tax-favored employer-sponsored retirement plan that is an eligible rollover distribution may be rolled over to an eligible retirement plan.[244] The rollover generally can be achieved by direct rollover (direct payment from the distributing plan to the recipient plan) or by contributing the distribution to the eligible retirement plan within 60 days of receiving the distribution ("60-day rollover").

Employer-sponsored retirement plans are required to offer an employee a direct rollover with respect to any eligible rollover distribution before paying the amount to the employee. If an eligible rollover distribution is not directly rolled over to an eligible retirement plan, the taxable portion of the distribution generally is subject to mandatory 20-percent income tax withholding.[245] Employees who do not elect a direct rollover but who roll over eligible distributions within 60 days of receipt also defer tax on the rollover amounts; however, the 20 percent withheld will remain taxable unless the employee substitutes funds within the 60-day period.

Plan loans

Employer-sponsored retirement plans may provide loans to employees. Unless the loan satisfies certain requirements in both form and operation, the amount of a retirement plan loan is a deemed distribution from the retirement plan, including that the terms of the loan provide for a repayment period of not more than five years (except for a loan specifically to purchase a home) and for level amortization of loan payments with payments not less frequently than quarterly.[246] Thus, if an employee stops making payments on a loan before the loan is repaid, a deemed distribution of the outstanding loan balance generally occurs. A deemed distribution of an unpaid loan balance is generally taxed as though an actual dis-

[242] Secs. 402(a) and (c), 402A(d), 403(a) and (b), 457(a) and (e)(16).
[243] Sec. 72(t).
[244] Certain distributions are not eligible rollover distributions, such as annuity payments, required minimum distributions, hardship distributions, and loans that are treated as deemed distributions under section 72(p).
[245] Treas. Reg. sec. 1.402(c)–2, Q&A–1(b)(3).
[246] Sec. 72(p).

tribution occurred, including being subject to a 10-percent early distribution tax, if applicable. A deemed distribution is not eligible for rollover to another eligible retirement plan.

A plan may also provide that, in certain circumstances (for example, if an employee terminates employment), an employee's obligation to repay a loan is accelerated and, if the loan is not repaid, the loan is cancelled and the amount in employee's account balance is offset by the amount of the unpaid loan balance, referred to as a loan offset. A loan offset is treated as an actual distribution from the plan equal to the unpaid loan balance (rather than a deemed distribution), and (unlike a deemed distribution) the amount of the distribution is eligible for tax-free rollover to another eligible retirement plan within 60 days. However, the plan is not required to offer a direct rollover with respect to a plan loan offset amount that is an eligible rollover distribution, and the plan loan offset amount is generally not subject to 20-percent income tax withholding.

REASONS FOR CHANGE

The Committee believes that providing a longer rollover period with respect to plan loan offsets may result in more rollovers, thus increasing retirement savings.

EXPLANATION OF PROVISION

Under the provision, the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution is extended from 60 days after the date of the offset to the due date (including extensions) for filing the Federal income tax return for the taxable year in which the plan loan offset occurs, that is, the taxable year in which the amount is treated as distributed from the plan. Under the provision, a qualified plan loan offset amount is a plan loan offset amount that is treated as distributed from a qualified retirement plan, a section 403(b) plan or a governmental section 457(b) plan solely by reason of the termination of the plan or the failure to meet the repayment terms of the loan because of the employee's separation from service, whether due to layoff, cessation of business, termination of employment, or otherwise. As under present law, a loan offset amount under the provision is the amount by which an employee's account balance under the plan is reduced to repay a loan from the plan.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

6. Modification of nondiscrimination rules for certain plans providing benefits or contributions to older, longer service participants (sec. 1506 of the bill and sec. 401 of the Code)

PRESENT LAW

In general

Qualified retirement plans are subject to nondiscrimination requirements, under which the group of employees covered by a plan ("plan coverage") and the contributions or benefits provided to employees, including benefits, rights, and features under the plan, must not discriminate in favor of highly compensated employees.[247] The timing of plan amendments must also not have the effect of discriminating significantly in favor of highly compensated employees. In addition, in the case of a defined benefit plan, the plan must benefit at least the lesser of (1) 50 employees and (2) the greater of 40 percent of all employees and two employees (or one employee if the employer has only one employee), referred to as the "minimum participation" requirements.[248] These nondiscrimination requirements are designed to help ensure that qualified retirement plans achieve the goal of retirement security for both lower and higher paid employees.

For nondiscrimination purposes, an employee generally is treated as highly compensated if the employee (1) was a five-percent owner of the employer at any time during the year or the preceding year, or (2) had compensation for the preceding year in excess of $120,000 (for 2017).[249] Employees who are not highly compensated are referred to as nonhighly compensated employees.

Nondiscriminatory plan coverage

Whether plan coverage of employees is nondiscriminatory is determined by calculating a plan's ratio percentage, that is, the ratio of the percentage of nonhighly compensated employees covered under the plan to the percentage of highly compensated employees covered. For this purpose, certain portions of a defined contribution plan are treated as separate plans to which the plan coverage requirements are applied separately, referred to as mandatory disaggregation. Specifically, the following, if provided under a plan, are treated as separate plans: the portion of a plan consisting of employee elective deferrals, the portion consisting of employer matching contributions, the portion consisting of employer nonelective contributions, and the portion consisting of an employee stock ownership plan ("ESOP").[250] Subject to mandatory disaggregation, different qualified retirement plans may otherwise be aggregated and tested together as a single plan, provided that they use the same plan year. The plan determined under these rules for plan coverage purposes generally is also treated as the plan for purposes of applying the other nondiscrimination requirements.

A plan's coverage is nondiscriminatory if the ratio percentage, as determined above, is 70 percent or greater. If a plan's ratio percentage is less than 70 percent, a multi-part test applies, referred

[247] Secs. 401(a)(3)–(5) and 410(b). Detailed rules are provided in Treas. Reg. secs. 1.401(a)(4)–1 through–13 and secs. 1.410(b)–2 through –10. In applying the nondiscrimination requirements, certain employees, such as those under age 21 or with less than a year of service, generally may be disregarded. In addition, employees of controlled groups and affiliated service groups under the aggregation rules of section 414(b), (c), (m) and (o) are treated as employed by a single employer.

[248] Sec. 401(a)(26).

[249] Sec. 414(q). At the election of the employer, employees who are highly compensated based on the amount of their compensation may be limited to employees who were among the top 20 percent of employees based on compensation.

[250] Elective deferrals are contributions that an employee elects to have made to a defined contribution plan that includes a qualified cash or deferred arrangement (referred to as "section 401(k) plan") rather than receive the same amount as current compensation. Employer matching contributions are contributions made by an employer only if an employee makes elective deferrals or after-tax employee contributions. Employer nonelective contributions are contributions made by an employer regardless of whether an employee makes elective deferrals or after-tax employee contributions. Under section 4975(e)(7), an ESOP is a defined contribution plan, or portion of a defined contribution plan, that is designated as an ESOP and is designed to invest primarily in employer stock.

to as the average benefit test. First, the plan must meet a "nondiscriminatory classification requirement," that is, it must cover a group of employees that is reasonable and established under objective business criteria and the plan's ratio percentage must be at or above a level specified in the regulations, which varies depending on the percentage of nonhighly compensated employees in the employer's workforce. In addition, the average benefit percentage test must be satisfied.

Under the average benefit percentage test, in general, the average rate of employer-provided contributions or benefit accruals for all nonhighly compensated employees under all plans of the employer must be at least 70 percent of the average contribution or accrual rate of all highly compensated employees.[251] In applying the average benefit percentage test, elective deferrals made by employees, as well as employer matching and nonelective contributions, are taken into account. Generally, all plans maintained by the employer are taken into account, including ESOPs, regardless of whether plans use the same plan year.

Under a transition rule applicable in the case of the acquisition or disposition of a business, or portion of a business, or a similar transaction, a plan that satisfied the plan coverage requirements before the transaction is deemed to continue to satisfy them for a period after the transaction, provided coverage under the plan is not significantly changed during that period.[252]

Nondiscriminatory contributions or benefit accruals

In general

There are three general approaches to testing the amount of benefits under qualified retirement plans: (1) design-based safe harbors under which the plan's contribution or benefit accrual formula satisfies certain uniformity standards, (2) a general test, described below, and (3) cross-testing of equivalent contributions or benefit accruals. Employee elective deferrals and employer matching contributions under defined contribution plans are subject to special testing rules and generally are not permitted to be taken into account in determining whether other contributions or benefits are nondiscriminatory.[253]

The nondiscrimination rules allow contributions and benefit accruals to be provided to highly compensated and nonhighly compensated employees at the same percentage of compensation.[254] Thus, the various testing approaches described below are generally applied to the amount of contributions or accruals provided as a percentage of compensation, referred to as a contribution rate or accrual rate. In addition, under the "permitted disparity" rules, in

[251] Contribution and benefit rates are generally determined under the rules for nondiscriminatory contributions or benefit accruals, described below. These rules are generally based on benefit accruals under a defined benefit plan, other than accruals attributable to after-tax employee contributions, and contributions allocated to participants' accounts under a defined contribution plan, other than allocations attributable to after-tax employee (Under these rules, contributions allocated to a participants accounts are referred to as "allocations," with the related rates referred to as "allocation rates," but "contribution rates" is used herein for convenience.) However, as discussed below, benefit accruals can be converted to actuarially equivalent contributions, and contributions can be converted to actuarially equivalent benefit accruals.

[252] Sec. 410(b)(6)(C).

[253] Secs. 401(k) and (m), the latter of which applies also to after-tax employee contributions under a defined contribution plan.

[254] For this purpose, under section 401(a)(17), compensation generally is limited to $265,000 per year (for 2016).

calculating an employee's contribution or accrual rate, credit may be given for the employer paid portion of Social Security taxes or benefits.[255] The permitted disparity rules do not apply in testing whether elective deferrals, matching contributions, or ESOP contributions are nondiscriminatory.

The general test is generally satisfied by measuring the rate of contribution or benefit accrual for each highly compensated employee to determine if the group of employees with the same or higher rate (a "rate" group) is a nondiscriminatory group, using the nondiscriminatory plan coverage standards described above. For this purpose, if the ratio percentage of a rate group is less than 70 percent, a simplified standard applies, which includes disregarding the reasonable classification requirement, but requires satisfaction of the average benefit percentage test.

Cross-testing

Cross-testing involves the conversion of contributions under a defined contribution plan or benefit accruals under a defined benefit plan to actuarially equivalent accruals or contributions, with the resulting equivalencies tested under the general test. However, employee elective deferrals and employer matching contributions under defined contribution plans are not permitted to be taken into account for this purpose, and cross-testing of contributions under a defined contribution plan, or cross-testing of a defined contribution plan aggregated with a defined benefit plan, is permitted only if certain threshold requirements are satisfied.

In order for a defined contribution plan to be tested on an equivalent benefit accrual basis, one of the following three threshold conditions must be met:

- The plan has broadly available allocation rates, that is, each allocation rate under the plan is available to a nondiscriminatory group of employees (disregarding certain permitted additional contributions provided to employees as a replacement for benefits under a frozen defined benefit plan, as discussed below);
- The plan provides allocations that meet prescribed designs under which allocations gradually increase with age or service or are expected to provide a target level of annuity benefit; or
- The plan satisfies a minimum allocation gateway, under which each nonhighly compensated employee has an allocation rate of (a) at least one-third of the highest rate for any highly compensated employee, or (b) if less, at least five percent.

In order for an aggregated defined contribution and defined benefit plan to be tested on an aggregate equivalent benefit accrual basis, one of the following three threshold conditions must be met:

- The plan must be primarily defined benefit in character, that is, for more than fifty percent of the nonhighly compensated employees under the plan, their accrual rate under the defined benefit plan exceeds their equivalent accrual rate under the defined contribution plan;
- The plan consists of broadly available separate defined benefit and defined contribution plans, that is, the defined benefit

[255] See sections 401(a)(5)(C) and (D) and 401(l) and Treas. Reg. section 1. 401(a)(4)–7 and 1.401(l)–1 through –6 for rules for determining the amount of contributions or benefits that can be attributed to the employer-paid portion of Social Security taxes or benefits.

plan and the defined contribution plan would separately satisfy simplified versions of the minimum coverage and nondiscriminatory amount requirements; or

- The plan satisfies a minimum aggregate allocation gateway, under which each nonhighly compensated employee has an aggregate allocation rate (consisting of allocations under the defined contribution plan and equivalent allocations under the defined benefit plan) of (a) at least one-third of the highest aggregate allocation rate for any nonhighly compensated employee, or (b) if less, at least five percent in the case of a highest nonhighly compensated employee's rate up to 25 percent, increased by one percentage point for each five-percentage-point increment (or portion thereof) above 25 percent, subject to a maximum of 7.5 percent.

Benefits, rights, and features

Each benefit, right, or feature offered under the plan generally must be available to a group of employees that has a ratio percentage that satisfies the minimum coverage requirements, including the reasonable classification requirement if applicable, except that the average benefit percentage test does not have to be met, even if the ratio percentage is less than 70 percent.

Multiple-employer and section 403(b) plans

A multiple-employer plan generally is a single plan maintained by two or more unrelated employers, that is, employers that are not treated as a single employer under the aggregation rules for related entities.[256] The plan coverage and other nondiscrimination requirements are applied separately to the portions of a multiple-employer plan covering employees of different employers.[257]

Certain tax-exempt charitable organizations may offer their employees a tax-deferred annuity plan ("section 403(b) plan).[258] The nondiscrimination requirements, other than the requirements applicable to elective deferrals, generally apply to section 403(b) plans of private tax-exempt organizations. For purposes of applying the nondiscrimination requirements to a section 403(b) plan, subject to mandatory disaggregation, a qualified retirement plan may be combined with the section 403(b) plan and treated as a single plan.[259] However, a section 403(b) plan and qualified retirement plan may not be treated as a single plan for purposes of applying the nondiscrimination requirements to the qualified retirement plan.

Closed and frozen defined benefit plans

A defined benefit plan may be amended to limit participation in the plan to individuals who are employees as of a certain date. That is, employees hired after that date are not eligible to participate in the plan. Such a plan is sometimes referred to as a "closed" defined benefit plan (that is, closed to new entrants). In such a

[256] Sec. 413(c). Multiple-employer status does not apply if the plan is a multiemployer plan, defined under sec. 414(f) as a plan maintained pursuant to one or more collective bargaining agreements with two or more unrelated employers and to which the employers are required to contribute under the collective bargaining agreement(s). Multiemployer plans are also known as Taft-Hartley plans.

[257] Treas. Reg. sec. 1.413–2(a)(3)(ii)–(iii).

[258] Sec. 403(b). These plans are available to employers that are tax-exempt under section 501(c)(3), as well as to educational institutions of State or local governments.

[259] Treas. Reg. sec. 1.410(b)–7(f).

case, it is common for the employer also to maintain a defined contribution plan and to provide employer matching or nonelective contributions only to employees not covered by the defined benefit plan or at a higher rate to such employees.

Over time, the group of employees continuing to accrue benefits under the defined benefit plan may come to consist more heavily of highly compensated employees, for example, because of greater turnover among nonhighly compensated employees or because increasing compensation causes nonhighly compensated employees to become highly compensated. In that case, the defined benefit plan may have to be combined with the defined contribution plan and tested on a benefit accrual basis. However, under the regulations, if none of the threshold conditions is met, testing on a benefits basis may not be available. Notwithstanding the regulations, recent IRS guidance provides relief for a limited period, allowing certain closed defined benefit plans to be aggregated with a defined contribution plan and tested on an aggregate equivalent benefits basis without meeting any of the threshold conditions.[260] When the group of employees continuing to accrue benefits under a closed defined benefit plan consists more heavily of highly compensated employees, the benefits, rights, and features provided under the plan may also fail the tests under the existing nondiscrimination rules.

In some cases, if a defined benefit plan is amended to cease future accruals for all participants, referred to as a "frozen" defined benefit plan, additional contributions to a defined contribution plan may be provided for participants, in particular for older participants, in order to make up in part for the loss of the benefits they expected to earn under the defined benefit plan ("make-whole" contributions). As a practical matter, testing on a benefit accrual basis may be required in that case, but may not be available because the defined contribution plan does not meet any of the threshold conditions.

REASONS FOR CHANGE

Some employers sponsoring defined benefit plans have determined that new employees prefer other types of compensation to defined benefit plans and have therefore closed their plans to new entrants. Existing employees continue to earn benefits under the plan, consistent with their expectations as to their compensation and retirement income, which is particularly important for employees close to retirement. However, without greater flexibility in the nondiscrimination rules, employers may be forced to freeze their defined benefit plans, thus preventing employees from earning their expected benefits. When a defined benefit plan is frozen, make-whole contributions can offset some of the resulting benefit loss for employees. In that case, too, greater flexibility in the nondiscrimination rules is needed. The Committee wishes to provide such flexibility in order to protect benefits for older, longer-service employees.

[260] Notice 2014–5, 2014–2 I.R.B. 276, extended by Notice 2015–28, 2015–14 14 I.R.B. 848, Notice 2016–57, 2016–40 I.R.B. 432, and Notice 2017–45, 2017–38 I.R.B. 232. Proposed regulations revising the nondiscrimination requirements for closed plans were also issued earlier this year, subject to various conditions. 81 Fed. Reg. 4976 (January 29, 2016).

EXPLANATION OF PROVISION

Closed or frozen defined benefit plans

In general

Under the provision, nondiscrimination relief applies with respect to benefits, rights, and features for a closed class of participants ("closed class"),[261] and with respect to benefit accruals for a closed class, under a defined benefit plan that meets the requirements described below (referred to herein as an "applicable" defined benefit plan). In addition, the provision treats a closed or frozen applicable defined benefit plan as meeting the minimum participation requirements if the plan met the requirements as of the effective date of the plan amendment by which the plan was closed or frozen.

If a portion of an applicable defined benefit plan eligible for relief under the provision is spun off to another employer, and if the spun-off plan continues to satisfy any ongoing requirements applicable for the relevant relief as described below, the relevant relief for the spun-off plan will continue with respect to the other employer.

Benefits, rights, or features for a closed class

Under the provision, an applicable defined benefit plan that provides benefits, rights, or features to a closed class does not fail the nondiscrimination requirements by reason of the composition of the closed class, or the benefits, rights, or features provided to the closed class, if (1) for the plan year as of which the class closes and the two succeeding plan years, the benefits, rights, and features satisfy the nondiscrimination requirements without regard to the relief under the provision, but taking into account the special testing rules described below,[262] and (2) after the date as of which the class was closed, any plan amendment modifying the closed class or the benefits, rights, and features provided to the closed class does not discriminate significantly in favor of highly compensated employees.

For purposes of requirement (1) above, the following special testing rules apply:

- In applying the plan coverage transition rule for business acquisitions, dispositions, and similar transactions, the closing of the class of participants is not treated as a significant change in coverage;
- Two or more plans do not fail to be eligible to be a treated as a single plan solely by reason of having different plan years;[263] and
- Changes in employee population are disregarded to the extent attributable to individuals who become employees or cease to be employees, after the date the class is closed, by reason of a merger, acquisition, divestiture, or similar event.

[261] References under the provision to a closed class of participants and similar references to a closed class include arrangements under which one or more classes of participants are closed, except that one or more classes of participants closed on different dates are not aggregated for purposes of determining the date any such class was closed.

[262] Other testing options available under present law are also available for this purpose.

[263] This rule applies also for purposes applying the plan coverage and other nondiscrimination requirements to an applicable defined benefit plan and one or more defined contributions that, under the provision, may be treated as a single plan as described below.

Benefit accruals for a closed class

Under the provision, an applicable defined benefit plan that provides benefits to a closed class may be aggregated, that is, treated as a single plan, and tested on a benefit accrual basis with one or more defined contribution plans (without having to satisfy the threshold conditions under present law) if (1) for the plan year as of which the class closes and the two succeeding plan years, the plan satisfies the plan coverage and nondiscrimination requirements without regard to the relief under the provision, but taking into account the special testing rules described above,[264] and (2) after the date as of which the class was closed, any plan amendment modifying the closed class or the benefits provided to the closed class does not discriminate significantly in favor of highly compensated employees.

Under the provision, defined contribution plans that may be aggregated with an applicable defined benefit plan and treated as a single plan include the portion of one or more defined contribution plans consisting of matching contributions, an ESOP, or matching or nonelective contributions under a section 403(b) plan. If an applicable defined benefit plan is aggregated with the portion of a defined contribution plan consisting of matching contributions, any portion of the defined contribution plan consisting of elective deferrals must also be aggregated. In addition, the matching contributions are treated in the same manner as nonelective contributions, including for purposes of permitted disparity.

Applicable defined benefit plan

An applicable defined benefit plan to which relief under the provision applies is a defined benefit plan under which the class was closed (or the plan frozen) before April 5, 2017, or that meets the following alternative conditions: (1) taking into account any predecessor plan, the plan has been in effect for at least five years as of the date the class is closed (or the plan is frozen) and (2) under the plan, during the five-year period preceding that date, (a) for purposes of the relief provided with respect to benefits, rights, and features for a closed class, there has not been a substantial increase in the coverage or value of the benefits, rights, or features, or (b) for purposes of the relief provided with respect to benefit accruals for a closed class or the minimum participation requirements, there has not been a substantial increase in the coverage or benefits under the plan.

For purposes of (2)(a) above, a plan is treated as having a substantial increase in coverage or value of benefits, rights, or features only if, during the applicable five-year period, either the number of participants covered by the benefits, rights, or features on the date the period ends is more than 50 percent greater than the number on the first day of the plan year in which the period began, or the benefits, rights, and features have been modified by one or more plan amendments in such a way that, as of the date the class is closed, the value of the benefits, rights, and features to the closed class as a whole is substantially greater than the value as of the first day of the five-year period, solely as a result of the amendments.

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[264] Other testing options available under present law are also available for this purpose.

For purposes of (2)(b) above, a plan is treated as having had a substantial increase in coverage or benefits only if, during the applicable five-year period, either the number of participants benefiting under the plan on the date the period ends is more than 50 percent greater than the number of participants on the first day of the plan year in which the period began, or the average benefit provided to participants on the date the period ends is more than 50 percent greater than the average benefit provided on the first day of the plan year in which the period began. In applying this requirement, the average benefit provided to participants under the plan is treated as having remained the same between the two relevant dates if the benefit formula applicable to the participants has not changed between the dates and, if the benefit formula has changed, the average benefit under the plan is considered to have increased by more than 50 percent only if the target normal cost for all participants benefiting under the plan for the plan year in which the five-year period ends exceeds the target normal cost for all such participants for that plan year if determined using the benefit formula in effect for the participants for the first plan year in the five-year period by more than 50 percent.[265] In applying these rules, a multiple-employer plan is treated as a single plan, rather than as separate plans separately covering the employees of each participating employer.

In applying these standards, any increase in coverage or value, or in coverage or benefits, whichever is applicable, is generally disregarded if it is attributable to coverage and value, or coverage and benefits, provided to employees who (1) became participants as a result of a merger, acquisition, or similar event that occurred during the 7-year period preceding the date the class was closed, or (2) became participants by reason of a merger of the plan with another plan that had been in effect for at least five years as of the date of the merger and, in the case of benefits, rights, or features for a closed class, under the merger, the benefits, rights, or features under one plan were conformed to the benefits, rights, or features under the other plan prospectively.

Make-whole contributions under a defined contribution plan

Under the provision, a defined contribution plan is permitted to be tested on an equivalent benefit accrual basis (without having to satisfy the threshold conditions under present law) if the following requirements are met:

- The plan provides make-whole contributions to a closed class of participants whose accruals under a defined benefit plan have been reduced or ended ("make-whole class");
- For the plan year of the defined contribution plan as of which the make-whole class closes and the two succeeding plan years, the make-whole class satisfies the nondiscriminatory

[265] Under the funding requirements applicable to defined benefit plans, target normal cost for a plan year (defined in section 430(b)(1)(A)(i)) is generally the sum of the present value of the benefits expected to be earned under the plan during the plan year plus the amount of plan-related expenses to be paid from plan assets during the plan year. Under the provision, in applying this average benefit rule to certain defined benefit plans maintained by cooperative organizations and charities, referred to as CSEC plans (defined in section 414(y)), which are subject to different funding requirements, the CSEC plan's normal cost under section 433(j)(1)(B) is used instead of target normal cost.

classification requirement under the plan coverage rules, taking into account the special testing rules described above;

- After the date as of which the class was closed, any amendment to the defined contribution plan modifying the make-whole class or the allocations, benefits, rights, and features provided to the make-whole class does not discriminate significantly in favor of highly compensated employees; and
- Either the class was closed before April 5, 2017, or the defined benefit plan is an applicable defined benefit plan under the alternative conditions applicable for purposes of the relief provided with respect to benefit accruals for a closed class.

With respect to one or more defined contribution plans meeting the requirements above, in applying the plan coverage and nondiscrimination requirements, the portion of the plan providing make-whole or other nonelective contributions may also be aggregated and tested on an equivalent benefit accrual basis with the portion of one or more other defined contribution plans consisting of matching contributions, an ESOP, or matching or nonelective contributions under a section 403(b) plan. If the plan is aggregated with the portion of a defined contribution plan consisting of matching contributions, any portion of the defined contribution plan consisting of elective deferrals must also be aggregated. In addition, the matching contributions are treated in the same manner as nonelective contributions, including for purposes of permitted disparity.

Under the provision, "make-whole contributions" generally means nonelective contributions for each employee in the make-whole class that are reasonably calculated, in a consistent manner, to replace some or all of the retirement benefits that the employee would have received under the defined benefit plan and any other plan or qualified cash or deferred arrangement under a section 401(k) plan if no change had been made to the defined benefit plan and other plan or arrangement.[266] However, under a special rule, in the case of a defined contribution plan that provides benefits, rights, or features to a closed class of participants whose accruals under a defined benefit plan have been reduced or eliminated, the plan will not fail to satisfy the nondiscrimination requirements solely by reason of the composition of the closed class, or the benefits, rights, or features provided to the closed class, if the defined contribution plan and defined benefit plan otherwise meet the requirements described above but for the fact that the make-whole contributions under the defined contribution plan are made in whole or in part through matching contributions.

If a portion of a defined contribution plan eligible for relief under the provision is spun off to another employer, and if the spun-off plan continues to satisfy any ongoing requirements applicable for the relevant relief as described above, the relevant relief for the spun-off plan will continue with respect to the other employer.

EFFECTIVE DATE

The provision is generally effective on the date of enactment without regard to whether any plan modifications referred to in the

[266] For this purpose, consistency is not required with respect to employees who were subject to different benefit formulas under the defined benefit plan.

provision are adopted or effective before, on, or after the date of enactment. However, at the election of a plan sponsor, the provision will apply to plan years beginning after December 31, 2013. For purposes of the provision, a closed class of participants under a defined benefit plan is treated as being closed before April 5, 2017, if the plan sponsor's intention to create the closed class is reflected in formal written documents and communicated to participants before that date. In addition, a plan does not fail to be eligible for the relief under the provision solely because (1) in the case of benefits, rights, or features for a closed class under a defined benefit plan, the plan was amended before the date of enactment to eliminate one or more benefits, rights, or features and is further amended after the date of enactment to provide the previously eliminated benefits, rights, or features to a closed class of participants, or (2) in the case of benefit accruals for a closed class under a defined benefit plan or application of the minimum benefit requirements to a closed or frozen defined benefit plan, the plan was amended before the date of the enactment to cease all benefit accruals and is further amended after the date of enactment to provide benefit accruals to a closed class of participants. In either case, the relevant relief applies only if the plan otherwise meets the requirements for the relief, and, in applying the relevant relief, the date the class of participants is closed is the effective date of the later amendment.

G. Estate, Gift, and Generation-Skipping Transfer Taxes

1. Increase in estate and gift tax exemption, followed by repeal of estate and generation-skipping transfer taxes and reduction in gift tax rate (secs. 1601 and 1602 of the bill, secs. 2010, 2056A, 2502, and 2505 of the Code, and new secs. 2210 and 2664 of the Code)

PRESENT LAW

In general

A gift tax is imposed on certain lifetime transfers, and an estate tax is imposed on certain transfers at death. A generation-skipping transfer tax generally is imposed on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.*, a beneficiary in a generation more than one generation younger than that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Income tax rules determine the recipient's tax basis in property acquired from a decedent or by gift. Gifts and bequests generally are excluded from the recipient's gross income.[267]

[267] Sec. 102.

Common features of the estate, gift, and generation-skipping transfer taxes

Unified credit (exemption) and tax rates

Unified credit.—A unified credit is available with respect to taxable transfers by gift and at death.[268] The unified credit offsets tax, computed using the applicable estate and gift tax rates, on a specified amount of transfers, referred to as the applicable exclusion amount, or exemption amount. The exemption amount was set at $5 million for 2011 and is indexed for inflation for later years.[269] For 2017, the inflation-indexed exemption amount is $5.49 million.[270] Exemption used during life to offset taxable gifts reduces the amount of exemption that remains at death to offset the value of a decedent's estate. An election is available under which exemption that is not used by a decedent may be used by the decedent's surviving spouse (exemption portability).

Common tax rate table.—A common tax-rate table with a top marginal tax rate of 40 percent is used to compute gift tax and estate tax. The 40-percent rate applies to transfers in excess of $1 million (to the extent not exempt). Because the exemption amount currently shields the first $5.49 million in gifts and bequests from tax, transfers in excess of the exemption amount generally are subject to tax at the highest marginal rate (40 percent).

Generation-skipping transfer tax exemption and rate.—The generation-skipping transfer tax is a separate tax that can apply in addition to either the gift tax or the estate tax. The tax rate and exemption amount for generation-skipping transfer tax purposes, however, are set by reference to the estate tax rules. Generation-skipping transfer tax is imposed using a flat rate equal to the highest estate tax rate (40 percent). Tax is imposed on cumulative generation-skipping transfers in excess of the generation-skipping transfer tax exemption amount in effect for the year of the transfer. The generation-skipping transfer tax exemption for a given year is equal to the estate tax exemption amount in effect for that year (currently $5.49 million).

Transfers between spouses.—A 100-percent marital deduction generally is permitted for the value of property transferred between spouses.[271] In addition, transfers of "qualified terminable interest property" also are eligible for the marital deduction. Qualified terminable interest property is property: (1) that passes from the decedent, (2) in which the surviving spouse has a "qualifying income interest for life," and (3) to which an election under these rules applies. A qualifying income interest for life exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or has the right to use the property during the spouse's life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

A marital deduction generally is denied for property passing to a surviving spouse who is not a citizen of the United States. A mar-

[268] Sec. 2010.

[269] For 2011 and later years, the gift and estate taxes were reunified, meaning that the gift tax exemption amount was increased to equal the estate tax exemption amount.

[270] For 2017, the $5.49 exemption amount results in a unified credit of $2,141,800, after applying the applicable rates set forth in section 2001(c).

[271] Secs. 2056 and 2523.

ital deduction is permitted, however, for property passing to a qualified domestic trust of which the noncitizen surviving spouse is a beneficiary. A qualified domestic trust is a trust that has as its trustee at least one U.S. citizen or U.S. corporation. No corpus may be distributed from a qualified domestic trust unless the U.S. trustee has the right to withhold any estate tax imposed on the distribution.

Tax is imposed on (1) any distribution from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of death of the noncitizen surviving spouse. The tax is computed as an additional estate tax on the estate of the first spouse to die.

Transfers to charity.—Contributions to section 501(c)(3) charitable organizations and certain other organizations may be deducted from the value of a gift or from the value of the assets in an estate for Federal gift or estate tax purposes.[272] The effect of the deduction generally is to remove the full fair market value of assets transferred to charity from the gift or estate tax base; unlike the income tax charitable deduction, there are no percentage limits on the deductible amount. For estate tax purposes, the charitable deduction is limited to the value of the transferred property that is required to be included in the gross estate.[273] A charitable contribution of a partial interest in property, such as a remainder or future interest, generally is not deductible for gift or estate tax purposes.[274]

The estate tax

Overview

The Code imposes a tax on the transfer of the taxable estate of a decedent who is a citizen or resident of the United States.[275] The taxable estate is determined by deducting from the value of the decedent's gross estate any deductions provided for in the Code. After applying tax rates to determine a tentative amount of estate tax, certain credits are subtracted to determine estate tax liability.[276]

Because the estate tax shares a common unified credit (exemption) and tax rate table with the gift tax, the exemption amounts and tax rates are described together above, along with certain other common features of these taxes.

[272] Secs. 2055 and 2522.
[273] Sec. 2055(d).
[274] Secs. 2055(e)(2) and 2522(c)(2).
[275] Sec. 2001(a).
[276] More mechanically, the taxable estate is combined with the value of adjusted taxable gifts made during the decedent's life (generally, post-1976 gifts), before applying tax rates to determine a tentative total amount of tax. The portion of the tentative tax attributable to lifetime gifts is then subtracted from the total tentative tax to determine the gross estate tax, i.e., the amount of estate tax before considering available credits. Credits are then subtracted to determine the estate tax liability.

This method of computation was designed to ensure that a taxpayer only gets one run up through the rate brackets for all lifetime gifts and transfers at death, at a time when the thresholds for applying the higher marginal rates exceeded the exemption amount. However, the higher ($5.49 million) present-law exemption amount effectively renders the lower rate brackets irrelevant, because the top marginal rate bracket applies to all transfers in excess of $1 million. In other words, all transfers that are not exempt by reason of the $5.49 million exemption amount are taxed at the highest marginal rate of 40 percent.

Gross estate

A decedent's gross estate includes, to the extent provided for in other sections of the Code, the date-of-death value of all of a decedent's property, real or personal, tangible or intangible, wherever situated.[277] In general, the value of property for this purpose is the fair market value of the property as of the date of the decedent's death, although an executor may elect to value certain property as of the date that is six months after the decedent's death (the alternate valuation date).[278]

The gross estate includes not only property directly owned by the decedent, but also other property in which the decedent had a beneficial interest at the time of his or her death.[279] The gross estate also includes certain transfers made by the decedent prior to his or her death, including: (1) certain gifts made within three years prior to the decedent's death;[280] (2) certain transfers of property in which the decedent retained a life estate;[281] (3) certain transfers taking effect at death;[282] and (4) revocable transfers.[283] In addition, the gross estate also includes property with respect to which the decedent had, at the time of death, a general power of appointment (generally, the right to determine who will have beneficial ownership).[284] The value of a life insurance policy on the decedent's life is included in the gross estate if the proceeds are payable to the decedent's estate or the decedent had incidents of ownership with respect to the policy at the time of his or her death.[285]

Deductions from the gross estate

A decedent's taxable estate is determined by subtracting from the value of the gross estate any deductions provided for in the Code.

Marital and charitable transfers.—As described above, transfers to a surviving spouse or to charity generally are deductible for estate tax purposes. The effect of the marital and charitable deductions generally is to remove assets transferred to a surviving spouse or to charity from the estate tax base.

State death taxes.—An estate tax deduction is permitted for death taxes (e.g., any estate, inheritance, legacy, or succession taxes) actually paid to any State or the District of Columbia, in respect of property included in the gross estate of the decedent.[286] Such State taxes must have been paid and claimed before the later of: (1) four years after the filing of the estate tax return; or (2) (a) 60 days after a decision of the U.S. Tax Court determining the estate tax liability becomes final, (b) the expiration of the period of extension to pay estate taxes over time under section 6166, or (c) the expiration of the period of limitations in which to file a claim for refund or 60 days after a decision of a court in which such refund suit has become final.

[277] Sec. 2031(a).
[278] Sec. 2032.
[279] Sec. 2033.
[280] Sec. 2035.
[281] Sec. 2036.
[282] Sec. 2037.
[283] Sec. 2038.
[284] Sec. 2041.
[285] Sec. 2042.
[286] Sec. 2058.

Other deductions.—A deduction is available for funeral expenses, estate administration expenses, and claims against the estate, including certain taxes.[287] A deduction also is available for uninsured casualty and theft losses incurred during the settlement of the estate.[288]

Credits against tax

After accounting for allowable deductions, a gross amount of estate tax is computed. Estate tax liability is then determined by subtracting allowable credits from the gross estate tax.

Unified credit.—The most significant credit allowed for estate tax purposes is the unified credit, which is discussed in greater detail above.[289] For 2017, the value of the unified credit is $2,141,800, which has the effect of exempting $5.49 million in transfers from tax. The unified credit available at death is reduced by the amount of unified credit used to offset gift tax on gifts made during the decedent's life.

Other credits.—Estate tax credits also are allowed for: (1) gift tax paid on certain pre-1977 gifts (before the estate and gift tax computations were integrated);[290] (2) estate tax paid on certain prior transfers (to limit the estate tax burden when estate tax is imposed on transfers of the same property in two estates by reason of deaths in rapid succession);[291] and (3) certain foreign death taxes paid (generally, where the property is situated in a foreign country but included in the decedent's U.S. gross estate).[292]

Provisions affecting small and family-owned businesses and farms

Special-use valuation.—An executor can elect to value for estate tax purposes certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current-use value, rather than its fair market value.[293] The maximum reduction in value for such real property is $750,000 (adjusted for inflation occurring after 1997; the inflation-adjusted amount for 2017 is $1,120,000). In general, real property generally qualifies for special-use valuation only if (1) at least 50 percent of the adjusted value of the decedent's gross estate (including both real and personal property) consists of a farm or closely-held business property in the decedent's estate and (2) at least 25 percent of the adjusted value of the gross estate consists of farm or closely held business real property. In addition, the property must be used in a qualified use (e.g., farming) by the decedent or a member of the decedent's family for five of the eight years before the decedent's death.

If, after a special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death, an additional estate tax is im-

[287] Sec. 2053.
[288] Sec. 2054.
[289] Sec. 2010.
[290] Sec. 2012.
[291] Sec. 2013.
[292] Sec. 2014. In certain cases, an election may be made to deduct foreign death taxes. See section 2053(d).
[293] Sec. 2032A.

posed to recapture the entire estate-tax benefit of the special-use valuation.[294]

Installment payment of estate tax for closely held businesses.—Under present law, the estate tax generally is due within nine months of a decedent's death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely held business in two or more installments (but no more than 10).[295] An estate is eligible for payment of estate tax in installments if the value of the decedent's interest in a closely held business exceeds 35 percent of the decedent's adjusted gross estate (i.e., the gross estate less certain deductions). If the election is made, the estate may defer payment of principal and pay only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax. A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998; the inflation-adjusted amount for 2017 is $1,490,000) in taxable value of a closely held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely held business in excess of $1 million (adjusted for inflation) is equal to 45 percent of the rate applicable to underpayments of tax under section 6621 of the Code (i.e., 45 percent of the Federal short-term rate plus three percentage points).[296] Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

The Gift Tax

Overview

The Code imposes a tax for each calendar year on the transfer of property by gift during such year by any individual, whether a resident or nonresident of the United States.[297] The amount of taxable gifts for a calendar year is determined by subtracting from the total amount of gifts made during the year: (1) the gift tax annual exclusion (described below); and (2) allowable deductions.

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[294] Prior to 2004, an estate also was permitted to deduct the adjusted value of a qualified family-owned business interest of the decedent, up to $675,000. Sec. 2057. A qualified family-owned business interest generally was defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if the decedent's family owns at least 50 percent of the trade or business, two families own 70 percent, or three families own 90 percent, as long as the decedent's family owns at least 30 percent of the trade or business. To qualify for the exclusion, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, at least one qualified heir (or member of the qualified heir's family) was required to have materially participated in the trade or business for at least 10 years following the decedent's death. The qualified family-owned business rules provided a graduated recapture based on the number of years after the decedent's death within which a disqualifying event occurred.

The qualified family-owned business deduction and the unified credit effective exemption amount were coordinated. If the maximum deduction amount of $675,000 is elected, then the unified credit effective exemption amount is $625,000, for a total of $1.3 million. If the qualified family-owned business deduction is less than $675,000, then the unified credit effective exemption amount is equal to $625,000, increased by the difference between $675,000 and the amount of the qualified family-owned business deduction. However, the unified credit effective exemption amount cannot be increased above such amount in effect for the taxable year. Because of the coordination between the qualified family-owned business deduction and the unified credit effective exemption amount, the qualified family-owned business deduction did not provide a benefit in any year in which the applicable exclusion amount exceeded $1.3 million.

[295] Sec. 6166.

[296] The interest rate on this portion adjusts with the Federal short-term rate.

[297] Sec. 2501(a).

Gift tax for the current taxable year is determined by: (1) computing a tentative tax on the combined amount of all taxable gifts for the current and all prior calendar years using the common gift tax and estate tax rate table; (2) computing a tentative tax only on all prior-year gifts; (3) subtracting the tentative tax on prior-year gifts from the tentative tax computed for all years to arrive at the portion of the total tentative tax attributable to current-year gifts; and, finally, (4) subtracting the amount of unified credit not consumed by prior-year gifts.

Because the gift tax shares a common unified credit (exemption) and tax rate table with the estate tax, the exemption amounts and tax rates are described together above, along with certain other common features of these taxes.

Transfers by gift

The gift tax applies to a transfer by gift regardless of whether: (1) the transfer is made outright or in trust; (2) the gift is direct or indirect; or (3) the property is real or personal, tangible or intangible.[298] For gift tax purposes, the value of a gift of property is the fair market value of the property at the time of the gift.[299] Where property is transferred for less than full consideration, the amount by which the value of the property exceeds the value of the consideration is considered a gift and is included in computing the total amount of a taxpayer's gifts for a calendar year.[300]

For a gift to occur, a donor generally must relinquish dominion and control over donated property. For example, if a taxpayer transfers assets to a trust established for the benefit of his or her children, but retains the right to revoke the trust, the taxpayer may not have made a completed gift, because the taxpayer has retained dominion and control over the transferred assets. A completed gift made in trust, on the other hand, often is treated as a gift to the trust beneficiaries.

By reason of statute, certain transfers are not treated as transfers by gift for gift tax purposes. These include, for example, certain transfers for educational and medical purposes,[301] transfers to section 527 political organizations,[302] and transfers to tax-exempt organizations described in sections 501(c)(4), (5), or (6).[303]

Taxable gifts

As stated above, the amount of a taxpayer's taxable gifts for the year is determined by subtracting from the total amount of the taxpayer's gifts for the year the gift tax annual exclusion and any available deductions.

Gift tax annual exclusion.—Under present law, donors of lifetime gifts are provided an annual exclusion of $14,000 per donee in 2017 (indexed for inflation from the 1997 annual exclusion amount of $10,000) for gifts of present interests in property during the taxable year.[304] If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $28,000 per donee

[298] Sec. 2511(a).
[299] Sec. 2512(a).
[300] Sec. 2512(b).
[301] Sec. 2503(e).
[302] Sec. 2501(a)(4).
[303] Sec. 2501(a)(6).
[304] Sec. 2503(b).

in 2017. In general, unlimited transfers between spouses are permitted without imposition of a gift tax. Special rules apply to the contributions to a qualified tuition program ("529 Plan") including an election to treat a contribution that exceeds the annual exclusion as a contribution made ratably over a five-year period beginning with the year of the contribution.[305]

Marital and charitable deductions.—As described above, transfers to a surviving spouse or to charity generally are deductible for gift tax purposes. The effect of the marital and charitable deductions generally is to remove assets transferred to a surviving spouse or to charity from the gift tax base.

The generation-skipping transfer tax

A generation-skipping transfer tax generally is imposed (in addition to the gift tax or the estate tax) on transfers, either directly or in trust or similar arrangement, to a "skip person" (*i.e.,* a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions.

Exemption and tax rate

An exemption generally equal to the estate tax exemption amount ($5.49 million for 2017) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property, and in some cases is automatically allocated. The allocation of generation-skipping transfer tax exemption effectively reduces the tax rate on a generation-skipping transfer.

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate (40 percent) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred indicates the amount of "generation-skipping transfer tax exemption" allocated to a trust (or to property transferred in a direct skip) relative to the total value of property transferred.[306] If, for example, a taxpayer transfers $5 million in property to a trust and allocates $5 million of exemption to the transfer, the inclusion ratio is zero, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is zero percent (40 percent multiplied by the inclusion ratio of zero). If, however, the taxpayer allocated only $2.5 million of exemption to the transfer, the inclusion ratio is 0.5, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is 20 percent (40 percent multiplied by the inclusion ratio of 0.5). If the taxpayer allocates no exemption to the transfer, the inclusion ratio is one, and the applicable tax rate on any subsequent generation-skipping transfers from the trust is 40 percent (40 percent multiplied by the inclusion ratio of one).

[305] Sec. 529(c)(2).

[306] The inclusion ratio is one minus the applicable fraction. The applicable fraction is the amount of exemption allocated to a trust (or to a direct skip) divided by the value of assets transferred.

Generation-skipping transfers

Generation-skipping transfer tax generally is imposed at the time of a generation-skipping transfer—a direct skip, a taxable termination, or a taxable distribution.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (*e.g.,* grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person.

A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates generation-skipping transfer tax exemption to a trust prior to the taxable distribution, generation-skipping transfer tax may be avoided.

Income tax basis in property received

In general

Gain or loss, if any, on the disposition of property is measured by the taxpayer's amount realized (*i.e.,* gross proceeds received) on the disposition, less the taxpayer's basis in such property. Basis generally represents a taxpayer's investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

A gift or bequest of appreciated (or loss) property is not an income tax realization event for the transferor. The Code provides special rules for determining a recipient's basis in assets received by lifetime gift or from a decedent.

Basis in property received by lifetime gift

Under present law, property received from a donor of a lifetime gift generally takes a carryover basis. "Carryover basis" means that the basis in the hands of the donee is the same as it was in the hands of the donor. The basis of property transferred by lifetime gift also is increased, but not above fair market value, by any gift tax paid by the donor. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the gift. If a donor's basis in property is greater than the fair market value of the property on the date of the gift, then, for purposes of determining loss on a subsequent sale of the property, the donee's basis is the property's fair market value on the date of the gift.

Basis in property acquired from a decedent

Property acquired from a decedent's estate generally takes a stepped-up basis. "Stepped-up basis" means that the basis of property acquired from a decedent's estate generally is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months after the decedent's death or the date the property is sold or distributed by the estate). Providing a fair market value basis eliminates the recognition of income on any appreciation of the property that occurred prior to the decedent's death and eliminates the tax benefit from any unrealized loss.

In community property states, a surviving spouse's one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country) generally is treated as having passed from the decedent and, thus, is eligible for stepped-up basis. Thus, both the decedent's one-half share and the surviving spouse's one-half share are stepped up to fair market value. This rule applies if at least one-half of the whole of the community interest is includible in the decedent's gross estate.

Stepped-up basis treatment generally is denied to certain interests in foreign entities. Stock in a passive foreign investment company (including those for which a mark-to-market election has been made) generally takes a carryover basis, except that stock of a passive foreign investment company for which a decedent shareholder had made a qualified electing fund election is allowed a stepped-up basis. Stock owned by a decedent in a domestic international sales corporation (or former domestic international sales corporation) takes a stepped-up basis reduced by the amount (if any) which would have been included in gross income under section 995(c) as a dividend if the decedent had lived and sold the stock at its fair market value on the estate tax valuation date (*i.e.,* generally the date of the decedent's death unless an alternate valuation date is elected).

REASONS FOR CHANGE

The Committee believes the Federal estate and generation-skipping transfer taxes harm taxpayers and the economy and therefore should be repealed. A tax on capital, such as the estate tax, motivates wealth holders to reduce savings and increase spending during life, rather than passing it to the next generation, ultimately increasing the consumption gap between the wealthy and poor. A tax on capital also causes investors to provide less capital to workers, thereby reducing wages in the long run.

The Committee is particularly concerned about the effect of the estate tax on the owners of farms and family businesses, which create jobs and support our economy. The estate tax hits such entrepreneurs especially hard, forcing families of deceased owners to make the difficult decision to sell all or part of the farm or business or take out costly loans to satisfy the estate tax liability.

EXPLANATION OF PROVISION

The provision doubles the estate and gift tax exemption amount for decedents dying and gifts made after December 31, 2017. This is accomplished by increasing the basic exclusion amount provided in section 2010(c)(3) of the Code from $5 million to $10 million. The $10 million amount is indexed for inflation occurring after 2011.

For estates of decedents dying and generation-skipping transfers made after December 31, 2024, the provision repeals the estate tax and the generation-skipping transfer tax. The provision includes a transition rule for assets placed in a qualified domestic trust by a decedent who died before the effective date of the provision. Specifically, estate tax will not be imposed on: (1) distributions before the death of a surviving spouse from the trust more than 10 years after the date of enactment; or (2) assets remaining in the qualified domestic trust upon the death of the surviving spouse. The top marginal gift tax rate is reduced to 35 percent for gifts made after December 31, 2024.

The provision generally retains the present law rules for determining the income tax basis of assets acquired by gift and assets acquired from a decedent. As a result, property received from a donor of a lifetime gift generally will continue to take a carryover basis, and property acquired from a decedent's estate generally will continue to take a stepped-up basis.

EFFECTIVE DATE

The doubling of the estate and gift tax exemption is effective for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2017. The repeal of the estate and generation-skipping transfer taxes, and the reduction in the gift tax rate to 35 percent, are effective for estates of decedents dying, generation-skipping transfers, and gifts made after December 31, 2024.

TITLE II—ALTERNATIVE MINIMUM TAX REPEAL

1. Repeal of alternative minimum tax (sec. 2001 of the bill and sec. 55 of the Code)

PRESENT LAW

Individual alternative minimum tax

In general

An alternative minimum tax ("AMT") is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. For taxable years beginning in 2017, the tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed $187,800 ($93,900 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The breakpoints are indexed for inflation. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the taxable income adjusted to take account of specified tax preferences and adjustments.

The exemption amounts for taxable years beginning in 2017 are: (1) $84,500 in the case of married individuals filing a joint return and surviving spouses; (2) $54,300 in the case of other unmarried individuals; (3) $42,250 in the case of married individuals filing separate returns; and (4) $24,100 in the case of an estate or trust. For taxable years beginning in 2017, the exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $160,900 in the case of married individuals filing a joint return and surviving spouses, (2) $120,700 in the case of other unmarried individuals, and (3) $80,450 in the case of married individuals filing separate returns or an estate or a trust. The amounts are indexed for inflation.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Preference items in computing AMTI

The minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of each mineral property (other than oil and gas properties) at the end of the taxable year.

2. The amount by which excess intangible drilling costs (*i.e.*, expenses in excess the amount that would have been allowable if amortized over a 10-year period) exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference applies to independent producers only to the extent it reduces the producer's AMTI (determined without regard to this preference and the net operating loss deduction) by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

5. Seven percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm activity or passive activities are not taken into account in computing AMTI.

Adjustments in computing AMTI

The adjustments that individuals must make to compute AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs are capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

4. Depreciation on property placed in service after 1986 and before January 1, 1999, is computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property acquired after September 10, 2001, which is allowed an additional allowance under section 168(k) for the regular tax is computed without regard to any AMT adjustments.

5. Mining exploration and development costs are capitalized and amortized over a 10-year period.

6. Taxable income from a long-term contract (other than a home construction contract) is computed using the percentage of completion method of accounting.

7. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), is calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

8. Miscellaneous itemized deductions are not allowed.

9. Itemized deductions for State, local, and foreign real property taxes; State and local personal property taxes; State, local, and foreign income, war profits, and excess profits taxes; and State and local sales taxes are not allowed.

10. Medical expenses are allowed only to the extent they exceed ten percent of the taxpayer's adjusted gross income.

11. Deductions for interest on home equity loans are not allowed.

12. The standard deduction and the deduction for personal exemptions are not allowed.

13. The amount allowable as a deduction for circulation expenditures is capitalized and amortized over a three-year period.

14. The amount allowable as a deduction for research and experimentation expenditures from passive activities is capitalized and amortized over a 10-year period.

15. The regular tax rules relating to incentive stock options do not apply.

Other rules

The taxpayer's net operating loss deduction generally cannot reduce the taxpayer's AMTI by more than 90 percent of the AMTI (determined without the net operating loss deduction).

The alternative minimum tax foreign tax credit reduces the tentative minimum tax.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax liability in such subsequent year. The AMT credit is allowed only to the extent that the taxpayer's AMT liability is the result of adjustments that are timing in nature. The individual AMT adjustments relating to itemized deductions and personal exemptions are not timing in nature, and no minimum tax credit is allowed with respect to these items.

An individual may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

Corporate alternative minimum tax

In general

An AMT is also imposed on a corporation to the extent the corporation's tentative minimum tax exceeds its regular tax. This tentative minimum tax is computed at the rate of 20 percent on the AMTI in excess of a $40,000 exemption amount that phases out. The exemption amount is phased out by an amount equal to 25 percent of the amount that the corporation's AMTI exceeds $150,000.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

A corporation with average gross receipts of less than $7.5 million for the prior three taxable years is exempt from the corporate minimum tax. The $7.5 million threshold is reduced to $5 million for the corporation's first three-taxable year period.

Preference items in computing AMTI

The corporate minimum tax preference items are:

1. The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. This preference does not apply to percentage depletion allowed with respect to oil and gas properties.

2. The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

3. Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds, certain housing bonds, and bonds issued in 2009 and 2010) issued after August 7, 1986.

4. Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

Adjustments in computing AMTI

The adjustments that corporations must make in computing AMTI are:

1. Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence. Depreciation on property which is allowed "bonus depreciation" for the regular tax is computed without regard to any AMT adjustments.

2. Mining exploration and development costs must be capitalized and amortized over a 10-year period.

3. Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

4. The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

5. The special rules applicable to Merchant Marine construction funds are not applicable.

6. The special deduction allowable under section 833(b) for Blue Cross and Blue Shield organizations is not allowed.

7. The adjusted current earnings adjustment applies, as described below.

Adjusted current earning ("ACE") adjustment

The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings of a corporation exceed its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction). In determining ACE the following rules apply:

1. For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.

2. Amounts excluded from gross income under the regular tax but included for purposes of determining earnings and profits are generally included in determining ACE.

3. The inside build-up of a life insurance contract is included in ACE (and the related premiums are deductible).

4. Intangible drilling costs of integrated oil companies must be capitalized and amortized over a 60-month period.

5. The regular tax rules of section 173 (allowing circulation expenses to be amortized) and section 248 (allowing organizational expenses to be amortized) do not apply.

6. Inventory must be calculated using the FIFO, rather than LIFO, method.

7. The installment sales method generally may not be used.

8. No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

9. Depletion (other than for oil and gas properties) must be calculated using the cost, rather than the percentage, method.

10. In certain cases, the assets of a corporation that has undergone an ownership change must be stepped down to their fair market values.

Other rules

The taxpayer's net operating loss carryover generally cannot reduce the taxpayer's AMT liability by more than 90 percent of AMTI determined without this deduction.

The various nonrefundable business credits allowed under the regular tax generally are not allowed against the AMT. Certain exceptions apply.

If a corporation is subject to AMT in any year, the amount of AMT is allowed as an AMT credit in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in the subsequent year. Corporations are allowed to claim a limited amount of AMT credits in lieu of bonus depreciation.

A corporation may elect to write off certain expenditures paid or incurred with respect of circulation expenses, research and experimental expenses, intangible drilling and development expenditures, development expenditures, and mining exploration expenditures over a specified period (three years in the case of circulation expenses, 60 months in the case of intangible drilling and development expenditures, and 10 years in case of other expenditures). The election applies for purposes of both the regular tax and the alternative minimum tax.

REASONS FOR CHANGE

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 Code. The AMT is particularly burdensome for individuals with small businesses, because they 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 invest in their businesses.

EXPLANATION OF PROVISION

The provision repeals the individual and corporate alternative minimum tax.

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

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

In determining the alternative minimum taxable income for taxable years beginning before January 1, 2018, the net operating loss deduction carryback from taxable years beginning after December 31, 2017, are determined without regard to any AMT adjustments or preferences.

The repeal of the election to write off certain expenditures over a specified period applies to amounts paid or incurred after December 31, 2017.

TITLE III—BUSINESS TAX REFORM

A. TAX RATES

1. Reduction in corporate tax rate (sec. 3001 of the bill and sec. 11 of the CODE)

PRESENT LAW

In general

Corporate taxable income is subject to tax under a four-step graduated rate structure.[307] The top corporate tax rate is 35 percent on taxable income in excess of $10 million. The corporate taxable income brackets and tax rates are as set forth in the table below.

Taxable Income	Tax rate (percent)
Not over $50,000	15
Over $50,000 but not over $75,000	25
Over $75,000 but not over $10,000,000	34
Over $10,000,000	35

An additional five-percent tax is imposed on a corporation's taxable income in excess of $100,000. The maximum additional tax is $11,750. Also, a second additional three-percent tax is imposed on a corporation's taxable income in excess of $15 million. The maximum second additional tax is $100,000.

Certain personal service corporations pay tax on their entire taxable income at the rate of 35 percent.[308]

[307] Sec. 11(a) and (b)(1).
[308] Sec. 11(b)(2).

Present law provides that, if the maximum corporate tax rate exceeds 35 percent, the maximum rate on a corporation's net capital gain will be 35 percent.[309]

Dividends received deduction

Corporations are allowed a deduction with respect to dividends received from other taxable domestic corporations.[310] The amount of the deduction is generally equal to 70 percent of the dividend received.

In the case of any dividend received from a 20-percent owned corporation, the amount of the deduction is equal to 80 percent of the dividend received.[311] The term "20-percent owned corporation" means any corporation if 20 percent or more of the stock of such corporation (by vote and value) is owned by the taxpayer. For this purpose, certain preferred stock is not taken into account.

In the case of a dividend received from a corporation that is a member of the same affiliated group, a corporation is generally allowed a deduction equal to 100 percent of the dividend received.[312]

REASONS FOR CHANGE

The United States has one of the highest statutory corporate tax rates among developed countries. The Committee believes that lowering the corporate tax rate is necessary to ensure domestic corporations remain globally competitive with their counterparts domiciled in the United States' largest international competitors. The average corporate income tax rate among nations in the Organisation for Economic Co-operation and Development is 22.5 percent. A low competitive corporate tax rate also contributes to making the United States an attractive location for foreign corporations to invest. In addition, a lower corporate tax rate means corporations will have more resources to invest in growing their businesses and creating jobs.

EXPLANATION OF PROVISION

The provision eliminates the graduated corporate rate structure and instead taxes corporate taxable income at 20 percent.

Personal service corporations are taxed at 25 percent.

The provision repeals the maximum corporate tax rate on net capital gain as obsolete.

The provision reduces the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent.[313]

For taxpayers subject to the normalization method of accounting (*e.g.,* regulated public utilities), the provision provides for the normalization of excess deferred tax reserves resulting from the reduction of corporate income tax rates (with respect to prior deprecia-

[309] Sec. 1201(a).

[310] Sec. 243(a). Such dividends are taxed at a maximum rate of 10.5 percent (30 percent of the top corporate tax rate of 35 percent).

[311] Sec. 243(c). Such dividends are taxed at a maximum rate of 7 percent (20 percent of the top corporate tax rate of 35 percent).

[312] Sec. 243(a)(3) and (b)(1). For this purpose, the term "affiliated group" generally has the meaning given such term by section 1504(a). Sec. 243(b)(2).

[313] Such dividends would be taxed at a maximum rate of 10 percent (50 percent of the top corporate tax rate of 20 percent) and 7 percent (35 percent of the top corporate tax rate of 20 percent), respectively.

tion or recovery allowances taken on assets placed in service before the date of enactment).

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

B. COST RECOVERY

1. Increased expensing (sec. 3101 of the bill and sec. 168(k) of the CODE)

PRESENT LAW

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[314] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,[315] and convention.[316]

Bonus depreciation

An additional first-year depreciation deduction is allowed equal to 50 percent of the adjusted basis of qualified property acquired and placed in service before January 1, 2020 (January 1, 2021, for longer production period property[317] and certain aircraft).[318] [319] The 50-percent allowance is phased down for property placed in service after December 31, 2017 (after December 31, 2018 for longer production period property and certain aircraft). The bonus depreciation percentage rates are as follows.

[314] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.,* section 280A.

[315] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87–56, 1987–2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88–22, 1988–1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87–56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[316] Sec. 168.

[317] As defined in section 168(k)(2)(B).

[318] As defined in section 168(k)(2)(C).

[319] Sec. 168(k). The additional first-year depreciation deduction is generally subject to the rules regarding whether a cost must be capitalized under section 263A.

Placed in Service Year	Bonus Depreciation Percentage	
	Qualified Property in General	Longer Production Period Property and Certain Aircraft
2017	50 percent	50 percent
2018	40 percent	50 percent [320]
2019	30 percent	40 percent
2020	n/a	30 percent [321]

The additional first-year depreciation deduction is allowed for both the regular tax and the alternative minimum tax ("AMT"),[322] but is not allowed in computing earnings and profits.[323] The basis of the property and the depreciation allowances in the year of purchase and later years are appropriately adjusted to reflect the additional first-year depreciation deduction.[324] The amount of the additional first-year depreciation deduction is not affected by a short taxable year.[325] The taxpayer may elect out of the additional first-year depreciation for any class of property for any taxable year.[326]

The interaction of the additional first-year depreciation allowance with the otherwise applicable depreciation allowance may be illustrated as follows. Assume that in 2017 a taxpayer purchases new depreciable property and places it in service.[327] The property's cost is $10,000, and it is five-year property subject to the 200 percent declining balance method and half-year convention. The amount of additional first-year depreciation allowed is $5,000. The remaining $5,000 of the cost of the property is depreciable under the rules applicable to five-year property.

Thus, $1,000 also is allowed as a depreciation deduction in 2017.[328] The total depreciation deduction with respect to the property for 2017 is $6,000. The remaining $4,000 adjusted basis of the property generally is recovered through otherwise applicable depreciation rules.

Qualified property

Property qualifying for the additional first-year depreciation deduction must meet all of the following requirements.[329] First, the property must be: (1) property to which MACRS applies with an applicable recovery period of 20 years or less; (2) water utility property;[330] (3) computer software other than computer software cov-

[320] It is intended that for longer production period property placed in service in 2018, 50 percent applies to the entire adjusted basis. Similarly, for longer production period property placed in service in 2019, 40 percent applies to the entire adjusted basis. A technical correction may be necessary with respect to longer production period property placed in service in 2018 and 2019 so that the statute reflects this intent.

[321] In the case of longer production period property described in section 168(k)(2)(B) and placed in service in 2020, 30 percent applies to the adjusted basis attributable to manufacture, construction, or production before January 1, 2020, and the remaining adjusted basis does not qualify for bonus depreciation. Thirty percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2020.

[322] Sec. 168(k)(2)(G). See also Treas. Reg. sec. 1.168(k)–1(d).

[323] Sec. 312(k)(3) and Treas. Reg. sec. 1.168(k)–1(f)(7).

[324] Sec. 168(k)(1)(B).

[325] *Ibid.*

[326] Sec. 168(k)(7). For the definition of a class of property, see Treas. Reg. sec. 1.168(k)–1(e)(2).

[327] Assume that the cost of the property is not eligible for expensing under section 179 or Treas. Reg. sec. 1.263(a)–1(f).

[328] $1,000 results from the application of the half-year convention and the 200 percent declining balance method to the remaining $5,000.

[329] Requirements relating to actions taken before 2008 are not described herein since they have little (if any) remaining effect.

[330] As defined in section 168(e)(5).

ered by section 197; or (4) qualified improvement property.[331] Second, the original use[332] of the property must commence with the taxpayer.[333] Third, the taxpayer must acquire the property within the applicable time period (as described below). Finally, the property must be placed in service before January 1, 2020. As noted above, an extension of the placed-in-service date of one year (*i.e.,* before January 1, 2021) is provided for certain property with a recovery period of 10 years or longer, certain transportation property, and certain aircraft.[334]

To qualify, property must be acquired (1) before January 1, 2020, or (2) pursuant to a binding written contract which was entered into before January 1, 2020. With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin the manufacture, construction, or production of the property before January 1, 2020.[335] Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be manufactured, constructed, or produced by the taxpayer.[336] For property eligible for the extended placed-in-service date, a special rule limits the amount of costs eligible for the additional first-year depreciation. With respect to such property, only the portion of the basis that is properly attributable to the costs incurred before January 1, 2020 ("progress expenditures") is eligible for the additional first-year depreciation deduction.[337]

Qualified improvement property

Qualified improvement property is any improvement to an interior portion of a building that is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.[338] Qualified improvement property does not include any improvement for which the expenditure is attrib-

[331] The additional first-year depreciation deduction is not available for any property that is required to be depreciated under the alternative depreciation system of MACRS. Sec. 168(k)(2)(D)(i).

[332] The term "original use" means the first use to which the property is put, whether or not such use corresponds to the use of such property by the taxpayer. If in the normal course of its business a taxpayer sells fractional interests in property to unrelated third parties, then the original use of such property begins with the first user of each fractional interest (*i.e.,* each fractional owner is considered the original user of its proportionate share of the property). Treas. Reg. sec. 1.168(k)–1(b)(3).

[333] A special rule applies in the case of certain leased property. In the case of any property that is originally placed in service by a person and that is sold to the taxpayer and leased back to such person by the taxpayer within three months after the date that the property was placed in service, the property would be treated as originally placed in service by the taxpayer not earlier than the date that the property is used under the leaseback. If property is originally placed in service by a lessor, such property is sold within three months after the date that the property was placed in service, and the user of such property does not change, then the property is treated as originally placed in service by the taxpayer not earlier than the date of such sale. Sec. 168(k)(2)(E)(ii) and (iii).

[334] Property qualifying for the extended placed-in-service date must have an estimated production period exceeding one year and a cost exceeding $1 million. Transportation property generally is defined as tangible personal property used in the trade or business of transporting persons or property. Certain aircraft which is not transportation property, other than for agricultural or firefighting uses, also qualifies for the extended placed-inservice date, if at the time of the contract for purchase, the purchaser made a nonrefundable deposit of the lesser of 10 percent of the cost or $100,000, and which has an estimated production period exceeding four months and a cost exceeding $200,000.

[335] Sec. 168(k)(2)(E)(i).

[336] Treas. Reg. sec. 1.168(k)–1(b)(4)(iii).

[337] Sec. 168(k)(2)(B)(ii). For purposes of determining the amount of eligible progress expenditures, rules similar to section 46(d)(3) as in effect prior to the Tax Reform Act of 1986 apply.

[338] Sec. 168(k)(3).

utable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Election to accelerate AMT credits in lieu of bonus depreciation

A corporation otherwise eligible for additional first-year depreciation may elect to claim additional AMT credits in lieu of claiming additional depreciation with respect to qualified property.[339] In the case of a corporation making this election, the straight line method is used for the regular tax and the AMT with respect to qualified property.[340]

A corporation making an election increases the tax liability limitation under section 53(c) on the use of minimum tax credits by the bonus depreciation amount. The aggregate increase in credits allowable by reason of the increased limitation is treated as refundable.

The bonus depreciation amount generally is equal to 20 percent of bonus depreciation for qualified property that could be claimed as a deduction absent an election under this provision.[341] As originally enacted, the bonus depreciation amount for all taxable years was limited to the lesser of (1) $30 million or (2) six percent of the minimum tax credits allocable to the adjusted net minimum tax imposed for taxable years beginning before January 1, 2006. However, extensions of this provision have provided that this limitation applies separately to property subject to each extension.

For taxable years ending after December 31, 2015, the bonus depreciation amount for a taxable year (as defined under present law with respect to all qualified property) is limited to the lesser of (1) 50 percent of the minimum tax credit for the first taxable year ending after December 31, 2015 (determined before the application of any tax liability limitation) or (2) the minimum tax credit for the taxable year allocable to the adjusted net minimum tax imposed for taxable years ending before January 1, 2016 (determined before the application of any tax liability limitation and determined on a first-in, first-out basis).

All corporations treated as a single employer under section 52(a) are treated as one taxpayer for purposes of the limitation, as well as for electing the application of this provision.[342]

In the case of a corporation making an election which is a partner in a partnership, for purposes of determining the electing partner's distributive share of partnership items, bonus depreciation does not apply to any qualified property and the straight line method is used with respect to that property.[343]

In the case of a partnership having a single corporate partner owning (directly or indirectly) more than 50 percent of the capital and profits interests in the partnership, each partner takes into account its distributive share of partnership depreciation in determining its bonus depreciation amount.[344]

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[339] Sec. 168(k)(4).

[340] Sec. 168(k)(4)(A)(ii).

[341] For this purpose, bonus depreciation is the difference between (i) the aggregate amount of depreciation determined if section 168(k)(1) applied to all qualified property placed in service during the taxable year and (ii) the amount of depreciation that would be so determined if section 168(k)(1) did not so apply. This determination is made using the most accelerated depreciation method and the shortest life otherwise allowable for each property.

[342] Sec. 168(k)(4)(B)(iii).

[343] Sec. 168(k)(4)(D)(ii).

[344] Sec. 168(k)(4)(D)(iii).

Special rules

Passenger automobiles

The limitation under section 280F on the amount of depreciation deductions allowed with respect to certain passenger automobiles is increased in the first year by $8,000 for automobiles that qualify (and for which the taxpayer does not elect out of the additional first-year deduction).[345] The $8,000 amount is phased down from $8,000 by $1,600 per calendar year beginning in 2018. Thus, the section 280F increase amount for property placed in service during 2018 is $6,400, and during 2019 is $4,800. While the underlying section 280F limitation is indexed for inflation,[346] the section 280F increase amount is not indexed for inflation. The increase does not apply to a taxpayer who elects to accelerate AMT credits in lieu of bonus depreciation for a taxable year.

Certain plants bearing fruits and nuts

A special election is provided for certain plants bearing fruits and nuts.[347] Under the election, the applicable percentage of the adjusted basis of a specified plant which is planted or grafted after December 31, 2015, and before January 1, 2020, is deductible for regular tax and AMT purposes in the year planted or grafted by the taxpayer, and the adjusted basis is reduced by the amount of the deduction.[348] The percentage is 50 percent for 2017, 40 percent for 2018, and 30 percent for 2019. A specified plant is any tree or vine that bears fruits or nuts, and any other plant that will have more than one yield of fruits or nuts and generally has a preproductive period of more than two years from planting or grafting to the time it begins bearing fruits or nuts.[349] The election is revocable only with the consent of the Secretary, and if the election is made with respect to any specified plant, such plant is not treated as qualified property eligible for bonus depreciation in the subsequent taxable year in which it is placed in service.

Long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[350] Solely for purposes of determining the percentage of completion under section 460(b)(1)(A), the cost of qualified property with a MACRS recovery period of seven years or less is taken into account as a cost allocated to the contract as if bonus depreciation had not been enacted for property placed in service before January 1, 2020 (January 1, 2021, in the case of longer production period property).[351]

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[345] Sec. 168(k)(2)(F).
[346] Sec. 280F(d)(7).
[347] See sec. 168(k)(5).
[348] Any amount deducted under this election is not subject to capitalization under section 263A.
[349] A specified plant does not include any property that is planted or grafted outside the United States.
[350] Sec. 460.
[351] Sec. 460(c)(6). Other dates involving prior years are not described herein.

REASONS FOR CHANGE

The Committee believes that providing full expensing for certain business assets lowers the cost of capital for tangible property used in a trade or business. With lower costs of capital, the Committee believes that businesses will be encouraged to purchase equipment and other assets, which will promote capital investment and provide economic growth. The Committee also believes that full expensing for certain business assets will eliminate depreciation recordkeeping requirements for such assets.

EXPLANATION OF PROVISION

Full expensing for certain business assets

The provision extends and modifies the additional first-year depreciation deduction through 2022 (through 2023 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023.

Special rules

The $8,000 increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles is increased to $16,000 for passenger automobiles acquired and placed in service after September 27, 2017, and before January 1, 2023.

The provision extends the special rule under the percentage-of-completion method for the allocation of bonus depreciation to a long-term contract for property placed in service before January 1, 2023 (January 1, 2024, in the case of longer production period property).

Application to used property

The provision removes the requirement that the original use of qualified property must commence with the taxpayer. Thus, the provision applies to purchases of used as well as new items. To prevent abuses, the additional first-year depreciation deduction applies only to property purchased in an arm's-length transaction. It does not apply to property received as a gift or from a decedent.[352] In the case of trade-ins, like-kind exchanges, or involuntary conversions, it applies only to any money paid in addition to the traded-in property or in excess of the adjusted basis of the replaced property.[353] It does not apply to property acquired in a nontaxable exchange such as a reorganization, to property acquired from a member of the taxpayer's family, including a spouse, ancestors, and lineal descendants, or from another related entity as defined in section 267, nor to property acquired from a person who controls, is controlled by, or is under common control with, the taxpayer.[354] Thus it does not apply, for example, if one member of an affiliated group of corporations purchases property from another member, or

[352] By reference to section 179(d)(2)(C). See also Treas. Reg. sec. 1.179–4(c)(1)(iv).
[353] By reference to section 179(d)(3). See also Treas. Reg. sec. 1.179–4(d).
[354] By reference to section 179(d)(2)(A) and (B). See also Treas. Reg. sec. 1.179–4(c).

if an individual who controls a corporation purchases property from that corporation.

Exception for certain businesses not subject to limitation on interest expense

The provision excludes from the definition of qualified property any property used in a real property trade or business, *i.e.,* any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business.[355]

The provision also excludes from the definition of qualified property any property used in the trade or business of certain regulated public utilities, *i.e.,* the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.[356]

In addition, the provision excludes from the definition of qualified property any property used in a trade or business that has had floor plan financing indebtedness,[357] unless the taxpayer with such trade or business is not a tax shelter prohibited from using the cash method and is exempt from the interest limitation rules in section 3301 of the bill by meeting the $25 million gross receipts test of section 448(c).

Election to accelerate AMT credits in lieu of bonus depreciation

As a conforming amendment to the repeal of AMT,[358] the provision repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Transition rule

The present-law phase-down of bonus depreciation is maintained for property acquired before September 28, 2017, and placed in service after September 27, 2017. Under the provision, in the case of property acquired and adjusted basis incurred before September 28, 2017, the bonus depreciation rates are as follows.

PHASE-DOWN FOR PORTION OF BASIS OF QUALIFIED PROPERTY ACQUIRED BEFORE SEPTEMBER 28, 2017

Placed in Service Year	Bonus Depreciation Percentage	
	Qualified Property in General	Longer Production Period Property and Certain Aircraft
2017	50 percent	50 percent.
2018	40 percent	50 percent.
2019	30 percent	40 percent.
2020	n/a	30 percent.

[355] As defined in section 3301 of the bill (Interest), by cross reference to section 469(c)(7)(C). Note that a mortgage broker who is a broker of financial instruments is not in a real property trade or business for this purpose. See, *e.g.,* CCA 201504010 (December 17, 2014).
[356] As defined in section 3301 of the bill (Interest).
[357] As defined in section 3301 of the bill (Interest).
[358] See section 2001 of the bill (Repeal of alternative minimum tax).

Similarly, the section 280F increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles acquired before September 28, 2017, and placed in service after September 27, 2017, is $8,000 for 2017, $6,400 for 2018, and $4,800 for 2019.

EFFECTIVE DATE

The provision generally applies to property acquired[359] and placed in service after September 27, 2017, and to specified plants planted or grafted after such date.

A transition rule provides that, for a taxpayer's first taxable year ending after September 27, 2017, the taxpayer may elect to apply section 168 without regard to the amendments made by this provision.

In the case of any taxable year that includes any portion of the period beginning on September 28, 2017, and ending on December 31, 2017, the amount of any net operating loss for such taxable year which may be treated as a net operating loss carryback is determined without regard to the amendments made by this provision.[360]

C. SMALL BUSINESS REFORMS

1. Expansion of section 179 expensing (sec. 3201 of the bill and sec. 179 of the CODE)

PRESENT LAW

A taxpayer generally must capitalize the cost of property used in a trade or business or held for the production of income and recover such cost over time through annual deductions for depreciation or amortization.[361] Tangible property generally is depreciated under the modified accelerated cost recovery system ("MACRS"), which determines depreciation for different types of property based on an assigned applicable depreciation method, recovery period,[362] and convention.[363]

Election to expense certain depreciable business assets

A taxpayer may elect under section 179 to deduct (or "expense") the cost of qualifying property, rather than to recover such costs through depreciation deductions, subject to limitation. The maximum amount a taxpayer may expense is $500,000 of the cost of qualifying property placed in service for the taxable year.[364] The

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[359] Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

[360] See section 3302 of the bill (Modification of net operating loss deduction).

[361] See secs. 263(a) and 167. However, where property is not used exclusively in a taxpayer's business, the amount eligible for a deduction must be reduced by the amount related to personal use. See, *e.g.,* section 280A.

[362] The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance. Exercising authority granted by Congress, the Secretary issued Rev. Proc. 87–56, 1987–2 C.B. 674, laying out the framework of recovery periods for enumerated classes of assets. The Secretary clarified and modified the list of asset classes in Rev. Proc. 88–22, 1988–1 C.B. 785. In November 1988, Congress revoked the Secretary's authority to modify the class lives of depreciable property. Rev. Proc. 87–56, as modified, remains in effect except to the extent that the Congress has, since 1988, statutorily modified the recovery period for certain depreciable assets, effectively superseding any administrative guidance with regard to such property.

[363] Sec. 168.

[364] Sec. 179(b)(1).

$500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $2,000,000.[365] The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2015.[366]

In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business.[367] Qualifying property also includes off-the-shelf computer software and qualified real property (*i.e.,* qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property).[368] Qualifying property excludes any property described in section 50(b) (*i.e.,* certain property not eligible for the investment tax credit).[369]

The amount eligible to be expensed for a taxable year may not exceed the taxable income for such taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision).[370] Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to limitations).

No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179.[371] If a corporation makes an election under section 179 to deduct expenditures, the full amount of the deduction does not reduce earnings and profits. Rather, the expenditures that are deducted reduce corporate earnings and profits ratably over a five-year period.[372]

An expensing election is made under rules prescribed by the Secretary.[373] In general, any election or specification made with respect to any property may not be revoked except with the consent of the Commissioner. However, an election or specification under section 179 may be revoked by the taxpayer without consent of the Commissioner.

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for tangible property used in a trade or business. With a lower cost of capital, the Committee believes small businesses will invest in more equipment and employ more workers. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. In order to increase the value of these benefits and the number of eligible taxpayers that may receive these benefits, the provision increases both the amount allowed to be expensed under section 179 and the amount of the phase-out threshold. In addition, in order to counteract the negative effect of infla-

[365] Sec. 179(b)(2).
[366] Sec. 179(b)(6).
[367] Passenger automobiles subject to the section 280F limitation are eligible for section 179 expensing only to the extent of the dollar limitations in section 280F. For sport utility vehicles above the 6,000 pound weight rating, which are not subject to the limitation under section 280F, the maximum cost that may be expensed for any taxable year under section 179 is $25,000. Sec. 179(b)(5).
[368] Sec. 179(d)(1)(A)(ii) and (f).
[369] Sec. 179(d)(1) flush language.
[370] Sec. 179(b)(3).
[371] Sec. 179(d)(9).
[372] Sec. 312(k)(3)(B).
[373] Sec. 179(c)(1).

tion on the limit and phase-out threshold of this provision for small businesses, the provision indexes such amounts for inflation.

The Committee also believes that qualified energy efficient heating and air-conditioning property should be included in the section 179 expensing provision to facilitate investment by small businesses in this type of real property.

EXPLANATION OF PROVISION

The provision increases the maximum amount a taxpayer may expense under section 179 to $5,000,000, and increases the phase-out threshold amount to $20,000,000 for five taxable years, *i.e.,* for taxable years beginning in 2018, 2019, 2020, 2021 and 2022. Thus, the provision provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2017 and before 2023, is $5,000,000 of the cost of qualifying property placed in service for the taxable year. The $5,000,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $20,000,000. The $5,000,000 and $20,000,000 amounts are indexed for inflation for taxable years beginning after 2018.

The provision also expands the definition of qualified real property under section 179 to include qualified energy efficient heating and air-conditioning property acquired and placed in service by the taxpayer after November 2, 2017. For purposes of the provision, qualified energy efficient heating and air-conditioning property means any depreciable section 1250 property that is (i) installed as part of a building's heating, cooling, ventilation, or hot water system, and (ii) within the scope of Standard 90.1–2007 of the American Society of Heating, Refrigerating, and Air-Conditioning Engineers and the Illuminating Engineering Society of North America (as in effect on the day before the date of the adoption of Standard 90.1–2010 of such Societies) or any successor standard.

EFFECTIVE DATE

The increased dollar limitations under section 179 apply to taxable years beginning after December 31, 2017.

The expansion of qualified real property to include qualified energy efficient heating and air-conditioning property applies to property acquired[374] and placed in service after November 2, 2017.

2. Small business accounting method reform and simplification (sec. 3202 of the bill and secs. 263A, 448, 460, and 471 of the Code)

PRESENT LAW

General rule for methods of accounting

Section 446 generally allows a taxpayer to select the method of accounting to be used to compute taxable income, provided that such method clearly reflects the income of the taxpayer. The term "method of accounting" includes not only the overall method of accounting used by the taxpayer, but also the accounting treatment of any one item.[375] Permissible overall methods of accounting in-

[374] Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

[375] Treas. Reg. sec. 1.446–1(a)(1).

clude the cash receipts and disbursements method ("cash method"), an accrual method, or any other method (including a hybrid method) permitted under regulations prescribed by the Secretary.[376] Examples of any one item for which an accounting method may be adopted include cost recovery,[377] revenue recognition,[378] and timing of deductions.[379] For each separate trade or business, a taxpayer is entitled to adopt any permissible method, subject to certain restrictions.[380]

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.[381] Except as otherwise provided, section 446(e) requires taxpayers to secure consent of the Secretary before changing a method of accounting. The regulations under this section provide rules for determining: (1) what a method of accounting is, (2) how an adoption of a method of accounting occurs, and (3) how a change in method of accounting is effectuated.[382]

Cash and accrual methods

Taxpayers using the cash method generally recognize items of income when actually or constructively received and items of expense when paid. The cash method is administratively easy and provides the taxpayer flexibility in the timing of income recognition. It is the method generally used by most individual taxpayers, including farm and nonfarm sole proprietorships.

Taxpayers using an accrual method generally accrue items of income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.[383] Taxpayers using an accrual method of accounting generally may not deduct items of expense prior to when all events have occurred that fix the obligation to pay the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred.[384] Accrual methods of accounting generally result in a more accurate measure of economic income than does the cash method. The accrual method is often used by businesses for financial accounting purposes.

A C corporation, a partnership that has a C corporation as a partner, or a tax-exempt trust or corporation with unrelated business income generally may not use the cash method. Exceptions are made for farming businesses, qualified personal service corporations, and the aforementioned entities to the extent their average annual gross receipts do not exceed $5 million for all prior years (including the prior taxable years of any predecessor of the entity) (the "gross receipts test"). The cash method may not be used by any tax shelter.[385] In addition, the cash method generally may

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[376] Sec. 446(c).
[377] See, *e.g.,* secs. 167 and 168.
[378] See, *e.g.,* secs. 451 and 460.
[379] See, *e.g.,* secs. 461 and 467.
[380] Sec. 446(d); Treas. Reg. sec. 1.446–1(d).
[381] Treas. Reg. sec. 1.446–1(e)(1).
[382] Treas. Reg. sec. 1.446–1(e).
[383] See, *e.g.,* sec. 451.
[384] See, *e.g.,* sec. 461.
[385] Secs. 448(a)(3) and (d)(3) and 461(i)(3) and (4). For this purpose, a tax shelter includes: (1) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale; (2) any syndicate (within the

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not be used if the purchase, production, or sale of merchandise is an income producing factor.[386] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[387]

A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees.[388] Such farming businesses are not precluded from using the cash method regardless of whether they meet the gross receipts test. However, section 447 generally requires a farming C corporation (and any farming partnership if a corporation is a partner in such partnership) to use an accrual method of accounting. Section 447 does not apply to nursery or sod farms, to the raising or harvesting of trees (other than fruit and nut trees), nor to farming C corporations meeting a gross receipts test with a $1 million threshold. For family farm C corporations, the threshold under the gross receipts test is $25 million.

A qualified personal service corporation is a corporation: (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates, or heirs.[389] Qualified personal service corporations are allowed to use the cash method without regard to whether they meet the gross receipts test.

Accounting for inventories

In general, for Federal income tax purposes, taxpayers must account for inventories if the production, purchase, or sale of merchandise is an income-producing factor to the taxpayer.[390] Treasury regulations also provide that in any case in which the use of inventories is necessary to clearly reflect income, the accrual method must be used with regard to purchases and sales.[391] However, an exception is provided for taxpayers whose average annual gross receipts do not exceed $1 million.[392] A second exception is provided for taxpayers in certain industries whose average annual gross receipts do not exceed $10 million and that are not otherwise prohibited from using the cash method under section 448.[393] Such taxpayers may account for inventory as materials and supplies that are not incidental (*i.e.,* "non-incidental materials and supplies").[394]

meaning of section 1256(e)(3)(B)); or (3) any tax shelter as defined in section 6662(d)(2)(C)(ii). In the case of a farming trade or business, a tax shelter includes any tax shelter as defined in section 6662(d)(2)(C)(ii) or any partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, (1) if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale or (2) if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

[386] Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1.

[387] Sec. 471 and Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1.

[388] Sec. 448(d)(1).

[389] Sec. 448(d)(2).

[390] Sec. 471(a) and Treas. Reg. sec. 1.471–1.

[391] Treas. Reg. sec. 1.446–1(c)(2).

[392] Rev. Proc. 2001–10, 2001–1 C.B. 272.

[393] Rev. Proc. 2002–28, 2002–1 C.B. 815.

[394] Treas. Reg. sec. 1.162–3(a)(1). A deduction is generally permitted for the cost of non-incidental materials and supplies in the taxable year in which they are first used or are consumed in the taxpayer's operations.

In those circumstances in which a taxpayer is required to account for inventory, the taxpayer must maintain inventory records to determine the cost of goods sold during the taxable period. Cost of goods sold generally is determined by adding the taxpayer's inventory at the beginning of the period to the purchases made during the period and subtracting from that sum the taxpayer's inventory at the end of the period.

Because of the difficulty of accounting for inventory on an item-by-item basis, taxpayers often use conventions that assume certain item or cost flows. Among these conventions are the first-in, first-out ("FIFO") method, which assumes that the items in ending inventory are those most recently acquired by the taxpayer, and the last-in, first-out ("LIFO") method, which assumes that the items in ending inventory are those earliest acquired by the taxpayer.

Uniform capitalization

The uniform capitalization rules require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be included in either inventory or capitalized into the basis of such property, as applicable.[395] For real or personal property acquired by the taxpayer for resale, section 263A generally requires certain direct and indirect costs allocable to such property to be included in inventory.

Section 263A provides a number of exceptions to the general uniform capitalization requirements. One such exception exists for certain small taxpayers who acquire property for resale and have $10 million or less of average annual gross receipts;[396] such taxpayers are not required to include additional section 263A costs in inventory. Another exception exists for taxpayers who raise, harvest, or grow trees.[397] Under this exception, section 263A does not apply to trees raised, harvested, or grown by the taxpayer (other than trees bearing fruit, nuts, or other crops, or ornamental trees) and any real property underlying such trees. Similarly, the uniform capitalization rules do not apply to any plant having a preproductive period of two years or less or to any animal, which is produced by a taxpayer in a farming business (unless the taxpayer is required to use an accrual method of accounting under section 447 or 448(a)(3)).[398] Freelance authors, photographers, and artists also are exempt from section 263A for any qualified creative expenses.[399]

Accounting for long-term contracts

In general, in the case of a long-term contract, the taxable income from the contract is determined under the percentage-of-completion method.[400] Under this method, the taxpayer must include in gross income for the taxable year an amount equal to the prod-

[395] Sec. 263A.

[396] Sec. 263A(b)(2)(B). No exception is available for small taxpayers who produce property subject to section 263A. However, a *de minimis* rule under Treasury regulations treats producers with total indirect costs of $200,000 or less as having no additional indirect costs beyond those normally capitalized for financial accounting purposes. Treas. Reg. sec. 1.263A–2(b)(3)(iv).

[397] Sec. 263A(c)(5).

[398] Sec. 263A(d).

[399] Sec. 263A(h). Qualified creative expenses are defined as amounts paid or incurred by an individual in the trade or business of being a writer, photographer, or artist. However, such term does not include any expense related to printing, photographic plates, motion picture files, video tapes, or similar items.

[400] Sec. 460(a).

uct of (1) the gross contract price and (2) the percentage of the contract completed during the taxable year.[401] The percentage of the contract completed during the taxable year is determined by comparing costs allocated to the contract and incurred before the end of the taxable year with the estimated total contract costs.[402] Costs allocated to the contract typically include all costs (including depreciation) that directly benefit or are incurred by reason of the taxpayer's long-term contract activities.[403] The allocation of costs to a contract is made in accordance with regulations.[404] Costs incurred with respect to the long-term contract are deductible in the year incurred, subject to general accrual method of accounting principles and limitations.[405]

An exception from the requirement to use the percentage-of-completion method is provided for certain construction contracts ("small construction contracts"). Contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer whose average annual gross receipts for the prior three taxable years do not exceed $10 million.[406] Thus, long-term contract income from small construction contracts must be reported consistently using the taxpayer's exempt contract method.[407] Permissible exempt contract methods include the completed contract method, the exempt-contract percentage-of-completion method, the percentage-of-completion method, or any other permissible method.[408]

REASONS FOR CHANGE

The Committee believes that the present law accounting method rules impose overly complex recordkeeping requirements that increase compliance costs for small businesses, as such rules have non-uniform small business exception requirements, rely on varying forms of gross receipts tests with widely different exception thresholds, and vary depending on the classification of a taxpayer's business activities. The Committee believes that using an accrual method, along with keeping inventory records, applying the uniform capitalization rules, and using the percentage-of-completion method, is more complicated than the cash method and any difference in income for a small business may be relatively small, such that either method may clearly reflect the income of a small business. In addition, the Committee believes that the cash method may address liquidity concerns of small businesses in that it measures income when the taxpayer is most likely to have the cash to pay any tax. The Committee also believes that the ability of small businesses to use simplified methods of accounting for inventory

[401] See Treas. Reg. sec. 1.460–4. This calculation is done on a cumulative basis. Thus, the amount included in gross income in a particular year is that proportion of the expected contract price that the amount of costs incurred through the end of the taxable year bears to the total expected costs, reduced by the amounts of gross contract price included in gross income in previous taxable years.

[402] Sec. 460(b)(1).

[403] Sec. 460(c).

[404] Treas. Reg. sec. 1.460–5.

[405] Treas. Reg. secs. 1.460–4(b)(2)(iv) and 1.460–1(b)(8).

[406] Secs. 460(e)(1)(B) and (4).

[407] Since such contracts involve the construction of real property, they are subject to the interest capitalization rules without regard to their duration. See Treas. Reg. sec. 1.263A–8.

[408] Treas. Reg. sec. 1.460–4(c)(1).

and certain construction contracts generally will be practical and administratively convenient for such taxpayers. In addition, the Committee believes that the uniform capitalization rules are relatively complex and any potential distortion to income caused by not applying such rules is not material enough to warrant the application of unduly burdensome rules to small businesses.

The Committee believes that a uniform definition of small business for determining applicable accounting method rules and consistent application of a gross receipts test will simplify tax administration and taxpayer compliance. An increase in the gross receipts test to $25 million will materially increase the number of business entities that are able to obtain relief from complex tax accounting rules. Many rules under present law prohibit a taxpayer from taking advantage of a small business accounting method exception if they ever fail to meet the relevant gross receipts test. The Committee believes that such taxpayers should be allowed to avail themselves of simplified accounting methods if they subsequently are able to meet the gross receipts test. Finally, the Committee believes that indexing the threshold for inflation will ensure that the small business definition remains an accurate reflection of the appropriate level of gross receipts for exempting entities from certain tax accounting rules.

EXPLANATION OF PROVISION

The provision expands the universe of taxpayers that may use the cash method of accounting. Under the provision, the cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test, regardless of whether the purchase, production, or sale of merchandise is an income-producing factor. The gross receipts test allows taxpayers with annual average gross receipts that do not exceed $25 million for the three prior taxable-year period (the "$25 million gross receipts test") to use the cash method. The $25 million amount is indexed for inflation for taxable years beginning after 2018.

The provision expands the universe of farming C corporations (and farming partnerships with a C corporation partner) that may use the cash method to include any farming C corporation (or farming partnership with a C corporation partner) that meets the $25 million gross receipts test.

The provision retains the exceptions from the required use of the accrual method for qualified personal service corporations and taxpayers other than C corporations. Thus, qualified personal service corporations, partnerships without C corporation partners, S corporations, and other passthrough entities are allowed to use the cash method without regard to whether they meet the $25 million gross receipts test, so long as the use of such method clearly reflects income.[409]

In addition, the provision also exempts certain taxpayers from the requirement to keep inventories. Specifically, taxpayers that meet the $25 million gross receipts test are not required to account

[409] Consistent with present law, the cash method generally may not be used by taxpayers, other than those that meet the $25 million gross receipts test, if the purchase, production, or sale of merchandise is an income-producing factor. In addition, the cash method may not be used by a tax shelter.

for inventories under section 471,[410] but rather may use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies,[411] or (2) conforms to the taxpayer's financial accounting treatment of inventories.[412]

The provision expands the exception for small taxpayers from the uniform capitalization rules. Under the provision, any producer or reseller that meets the $25 million gross receipts test is exempted from the application of section 263A.[413] The provision retains the exemptions from the uniform capitalization rules that are not based on a taxpayer's gross receipts.

Finally, the provision expands the exception for small construction contracts from the requirement to use the percentage-of-completion method. Under the provision, contracts within this exception are those contracts for the construction or improvement of real property if the contract: (1) is expected (at the time such contract is entered into) to be completed within two years of commencement of the contract and (2) is performed by a taxpayer that (for the taxable year in which the contract was entered into) meets the $25 million gross receipts test.[414]

Under the provision, a taxpayer who fails the $25 million gross receipts test would not be eligible for any of the aforementioned exceptions (*i.e.,* from the accrual method, from keeping inventories, from applying the uniform capitalization rules, or from using the percentage-of-completion method) for such taxable year.

EFFECTIVE DATE

The provisions to expand the universe of taxpayers, including farming C corporations, eligible to use the cash method, exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules apply to taxable years beginning after December 31, 2017. Application of these rules is a change in the taxpayer's method of accounting for purposes of section 481.

The provision to expand the exception for small construction contracts from the requirement to use the percentage-of-completion method applies to contracts entered into after December 31, 2017, in taxable years ending after such date. Application of this rule is a change in the taxpayer's method of accounting for purposes of section 481. Application of the exception for small construction contracts from the requirement to use the percentage-of-completion method is applied on a cutoff basis for all similarly classified contracts (hence there is no adjustment under section 481(a) for contracts entered into before January 1, 2018).

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[410] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership.

[411] Consistent with present law, a deduction is generally permitted for the cost of non-incidental materials and supplies in the taxable year in which they are first used or are consumed in the taxpayer's operations. See Treas. Reg. sec. 1.162–3(a)(1).

[412] The taxpayer's financial accounting treatment of inventories is determined by reference to the method of accounting used in the taxpayer's applicable financial statement (as defined in section 3202 of the bill (Small business accounting method reform and simplification)) or, if the taxpayer does not have an applicable financial statement, the method of accounting used in the taxpayer's book and records prepared in accordance with the taxpayer's accounting procedures.

[413] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership.

[414] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship is a corporation or partnership.

3. Small business exception from limitation on deduction of business interest (sec. 3203 of the bill and sec. 163(j) of the Code)

For present law, reasons for change, explanation of provision, and effective date for the small business exception from the limitation on the deduction of business interest, see section 3301 of the bill (Interest).

4. Modification of treatment of S corporation conversions to C corporations (sec. 3204 of the bill and secs. 481 and 1371 of the Code)

PRESENT LAW

Changes in accounting method

Cash and accrual methods in general

Taxpayers using the cash method generally recognize items of income when actually or constructively received and items of expense when paid. The cash method is administratively easy and provides the taxpayer flexibility in the timing of income recognition. It is the method generally used by most individual taxpayers, including farm and nonfarm sole proprietorships.

Taxpayers using an accrual method generally accrue items of income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy.[415] Taxpayers using an accrual method of accounting generally may not deduct items of expense prior to when all events have occurred that fix the obligation to pay the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred.[416] Accrual methods of accounting generally result in a more accurate measure of economic income than does the cash method. The accrual method is often used by businesses for financial accounting purposes.

A C corporation, a partnership that has a C corporation as a partner, or a tax-exempt trust or corporation with unrelated business income generally may not use the cash method. Exceptions are made for farming businesses,[417] qualified personal service corporations,[418] and the aforementioned entities to the extent their average annual gross receipts do not exceed $5 million for all prior years (including the prior taxable years of any predecessor of the entity) (the "gross receipts test").[419] The cash method may not be used by any tax shelter.[420] In addition, the cash method generally

[415] See, *e.g.*, sec. 451.

[416] See, *e.g.*, sec. 461.

[417] A farming business is defined as a trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees. Sec. 448(d)(1).

[418] A qualified personal service corporation is a corporation (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates, or heirs. Sec. 448(d)(2).

[419] The gross receipts test is modified to apply to taxpayers with annual average gross receipts that do not exceed $25 million for the three prior taxable-year period as part of this bill. See section 3202 of the bill (Small business accounting method reform and simplification).

[420] Secs. 448(a)(3) and (d)(3) and 461(i)(3) and (4). For this purpose, a tax shelter includes: (1) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency

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may not be used if the purchase, production, or sale of merchandise is an income producing factor.[421] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[422]

Procedures for changing a method of accounting

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.[423] Except as otherwise provided, section 446(e) requires taxpayers to secure consent of the Secretary before changing a method of accounting. The regulations under this section provide rules for determining: (1) what a method of accounting is, (2) how an adoption of a method of accounting occurs, and (3) how a change in method of accounting is effectuated.[424]

Section 481 prescribes the rules to be followed in computing taxable income in cases where the taxable income of the taxpayer is computed under a different method than the prior year (*e.g.*, when changing from the cash method to an accrual method). In computing taxable income for the year of change, the taxpayer must take into account those adjustments which are determined to be necessary solely by reason of such change in order to prevent items of income or expense from being duplicated or omitted.[425] The year of change is the taxable year for which the taxable income of the taxpayer is computed under a different method than the prior year.[426] Congress has provided the Secretary with the authority to prescribe the timing and manner in which such adjustments are taken into account in computing taxable income.[427] Net adjustments that decrease taxable income generally are taken into account entirely in the year of change, and net adjustments that increase taxable income generally are taken into account ratably during the four-taxable-year period beginning with the year of change.[428]

Post-termination distributions

Under present law, in the case of an S corporation that converts to a C corporation, distributions of cash by the C corporation to its

having the authority to regulate the offering of securities for sale; (2) any syndicate (within the meaning of section 1256(e)(3)(B)); or (3) any tax shelter as defined in section 6662(d)(2)(C)(ii). In the case of a farming trade or business, a tax shelter includes any tax shelter as defined in section 6662(d)(2)(C)(ii) or any partnership or any other enterprise other than a corporation which is not an S corporation engaged in the trade or business of farming, (1) if at any time interests in such partnership or enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having authority to regulate the offering of securities for sale or (2) if more than 35 percent of the losses during any period are allocable to limited partners or limited entrepreneurs.

[421] Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1.

[422] Sec. 471 and Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1. However, section 3202 of the bill (Small business accounting method reform and simplification) provides an exemption from the requirement to use inventories for taxpayers that meet the $25 million gross receipts test provided in such section. Accordingly, under the bill, such taxpayers are thus also eligible to use the cash method.

[423] Treas. Reg. sec. 1.446–1(e)(1).

[424] Treas. Reg. sec. 1.446–1(e).

[425] Sec. 481(a)(2) and Treas. Reg. sec. 1.481–1(a)(1).

[426] Treas. Reg. sec. 1.481–1(a)(1).

[427] Sec. 481(c). While Treasury regulations generally provide that the entire adjustments required by section 481(a) are taken into account entirely in the year of change, the Secretary has provided the Commissioner with the authority to provide additional guidance regarding the taxable year or years in which the adjustments are taken into account. See Treas. Reg. sec. 1.481–1(c)(2).

[428] See Section 7.03 of Rev. Proc. 2015–13, 2015–5 I.R.B 419.

shareholders during the post-termination transition period (to the extent of the amount in the accumulated adjustment account) are tax-free to the shareholders and reduce the adjusted basis of the stock.[429] The post-termination transition period is generally the one-year period after the S corporation election terminates.[430]

REASONS FOR CHANGE

The Committee recognizes that, with the significant modifications to the tax code with respect to both S corporations and C corporations in this bill, taxpayers that previously elected to be taxed as S corporations may prefer instead to be taxed as C corporations. The Committee acknowledges that the revocation of an S election may require certain taxpayers to change from the cash method to an accrual method, and may have other effects on the taxpayer. Accordingly, the Committee believes that it is important to provide rules to ease the transition from S corporation to C corporation for the affected taxpayers.

EXPLANATION OF PROVISION

Under the provision, any section 481(a) adjustment of an eligible terminated S corporation attributable to the revocation of its S corporation election (i.e., a change from the cash method to an accrual method) is taken into account ratably during the six-taxable-year period beginning with the year of change.[431] An eligible terminated S corporation is any C corporation which (1) is an S corporation the day before the enactment of this bill, (2) during the two-year period beginning on the date of such enactment revokes its S corporation election under section 1362(a), and (3) all of the owners of which on the date the S corporation election is revoked are the same owners (and in identical proportions) as the owners on the date of such enactment.

Under the provision, in the case of a distribution of money by an eligible terminated S corporation, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of the accumulated adjustments account bears to the amount the accumulated earnings and profits.

EFFECTIVE DATE

The provision is effective upon enactment.

[429] Sec. 1371(e)(1).

[430] Sec. 1377(b).

[431] Section 3202 of the bill (Small business accounting method reform and simplification) expand the universe of partnerships and C corporations eligible to use the cash method to include partnerships or C corporations with annual average gross receipts that do not exceed $25 million for the three prior taxable-year period. Accordingly, an eligible terminated S corporation with annual average gross receipts that do not exceed $25 million that used the cash method prior to revoking its S corporation election may be eligible to remain on the cash method as a C corporation.

D. Reform of Business-related Exclusions, Deductions, etc.

1. Interest (sec. 3301 of the bill and sec. 163(j) of the Code)

PRESENT LAW

Interest deduction

Interest paid or accrued by a business generally is deductible in the computation of taxable income subject to a number of limitations.[432]

Interest is generally deducted by a taxpayer as it is paid or accrued, depending on the taxpayer's method of accounting. For all taxpayers, if an obligation is issued with original issue discount ("OID"), a deduction for interest is allowable over the life of the obligation on a yield to maturity basis.[433] Generally, OID arises where interest on a debt instrument is not calculated based on a qualified rate and required to be paid at least annually.

Investment interest expense

In the case of a taxpayer other than a corporation, the deduction for interest on indebtedness that is allocable to property held for investment ("investment interest") is limited to the taxpayer's net investment income for the taxable year.[434] Disallowed investment interest is carried forward to the next taxable year.

Net investment income is investment income net of investment expenses. Investment income generally consists of gross income from property held for investment, and investment expense includes all deductions directly connected with the production of investment income (e.g., deductions for investment management fees) other than deductions for interest. Investment income includes only so much of the taxpayer's net capital gain and qualified dividend income as the taxpayer elects to take into account as investment income.

The two-percent floor on miscellaneous itemized deductions allows taxpayers to deduct investment expenses connected with investment income only to the extent such deductions exceed two percent of the taxpayer's adjusted gross income ("AGI").[435] Miscellaneous itemized deductions[436] that are not investment expenses are disallowed first before any investment expenses are disallowed.[437]

[432] Sec. 163(a). In addition to the limitations discussed herein, other limitations include: denial of the deduction for the disqualified portion of the original issue discount on an applicable high yield discount obligation (sec. 163(e)(5)), denial of deduction for interest on certain obligations not in registered form (sec. 163(f)), reduction of the deduction for interest on indebtedness with respect to which a mortgage credit certificate has been issued under section 25 (sec. 163(g)), disallowance of deduction for personal interest (sec. 163(h)), disallowance of deduction for interest on debt with respect to certain life insurance contracts (sec. 264), and disallowance of deduction for interest relating to tax-exempt income (sec. 265). Interest may also be subject to capitalization. See, e.g., sections 263A(f) and 461(g).

[433] Sec. 163(e). But see section 267 (dealing in part with interest paid to a related or foreign party).

[434] Sec. 163(d).

[435] Sec. 67(a).

[436] Miscellaneous itemized deductions include itemized deductions of individuals other than certain specific itemized deductions. Sec. 67(b). Miscellaneous itemized deductions generally include, for example, investment management fees and certain employee business expenses, but specifically do not include, for example, interest, taxes, casualty and theft losses, charitable contributions, medical expenses, or other listed itemized deductions.

[437] H.R. Rep. No. 841, 99th Cong., 2d Sess., p. II–154, Sept. 18, 1986 (Conf. Rep.) ("In computing the amount of expenses that exceed the 2-percent floor, expenses that are not investment expenses are intended to be disallowed before any investment expenses are disallowed.").

For purposes of the investment interest limitation, debt is allocated under a tracing approach to expenditures in accordance with the use of the debt proceeds, and interest on the debt is allocated in the same manner.[438] Thus, generally, the disallowance of a deduction for investment interest depends on the individual's use of the proceeds of the debt. For example, if an individual pledges corporate stock held for investment as security for a loan and uses the debt proceeds to purchase a car for personal use, interest expense on the debt is allocated to the personal expenditure to purchase the car and is treated as nondeductible personal interest rather than investment interest.

Earnings stripping

Section 163(j) may disallow a deduction for disqualified interest paid or accrued by a corporation in a taxable year if two threshold tests are satisfied: the payor's debt-to-equity ratio exceeds 1.5 to 1.0 (the safe harbor ratio) and the payor's net interest expense exceeds 50 percent of its adjusted taxable income (generally, taxable income computed without regard to deductions for net interest expense, net operating losses, domestic production activities under section 199, depreciation, amortization, and depletion). Disqualified interest includes interest paid or accrued to: (1) related parties when no Federal income tax is imposed with respect to such interest;[439] (2) unrelated parties in certain instances in which a related party guarantees the debt; or (3) to a real estate investment trust ("REIT") by a taxable REIT subsidiary of that trust.[440] Interest amounts disallowed under these rules can be carried forward indefinitely.[441] 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.[442]

REASONS FOR CHANGE

The Committee believes that the general deductibility of interest payments on debt may result in companies undertaking more leverage than they would in the absence of the tax system. The effective marginal tax rate on debt-financed investment is lower than that on equity-financed investment.[443] Limiting the deductibility of interest along with reducing the corporate tax rate narrows the disparity in the effective marginal tax rates based on different sources of financing. This leads to a more efficient capital structure for firms. The Committee believes that it is necessary to apply the limitation on the deductibility of interest to businesses regardless of the form in which such businesses are organized so as not to create distortions in the choice of entity.

[438] Temp. Treas. Reg. sec. 1.163–8T(c).

[439] If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed by the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

[440] Sec. 163(j)(3).

[441] Sec. 163(j)(1)(B).

[442] Sec. 163(j)(2)(B)(ii).

[443] For a discussion of effective marginal tax rates on investment, see Joint Committee on Taxation, *Economic Growth and Tax Policy* (JCX–19–17), May 16, 2017, p. 15ff.

The Committee believes that limitations on the deductibility of interest should be applied to those businesses with the greatest levels of leverage. Such firms may pose the greatest societal costs in times of financial distress. Smaller firms are likely to impose smaller costs on the economy than larger firms. Additionally, smaller firms have limited access to public equity capital markets as compared to larger firms. Thus, the Committee believes it is appropriate to limit the interest deduction of only the largest taxpayers.

The Committee understands that some taxpayers who do not consistently incur excessive amounts of leverage may nonetheless at times incur an amount of interest expense that is large in relation to its taxable income. For instance, a bad year in a business cycle might reduce taxable income to the point where a limitation based on taxable income takes effect. Furthermore, earnings attributable to investments financed by debt and interest payments associated with such debt may arise in different periods. For that reason, the Committee believes taxpayers should be able to average annual results, and so believes the carryforward of denied interest deductions is appropriate for a period of time.

The Committee recognizes that certain types of trades or businesses have particular characteristics that warrant special rules related to interest deductibility.

EXPLANATION OF PROVISION

In general

In the case of any taxpayer for any taxable year, the deduction for business interest is limited to the sum of (1) business interest income; (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year; and (3) the floor plan financing interest of the taxpayer for the taxable year. The amount of any business interest not allowed as a deduction for any taxable year may be carried forward for up to five years beyond the year in which the business interest was paid or accrued, treating business interest as allowed as a deduction on a first-in, first-out basis. The limitation applies at the taxpayer level. In the case of a group of affiliated corporations that file a consolidated return, the limitation applies at the consolidated tax return filing level.

Business interest means any interest paid or accrued on indebtedness properly allocable to a trade or business. Any amount treated as interest for purposes of the Internal Revenue Code is interest for purposes of the provision. Business interest income means the amount of interest includible in the gross income of the taxpayer for the taxable year which is properly allocable to a trade or business. Business interest does not include investment interest, and business interest income does not include investment income, within the meaning of section 163(d).[444]

Adjusted taxable income means the taxable income of the taxpayer computed without regard to (1) any item of income, gain, deduction, or loss which is not properly allocable to a trade or business; (2) any business interest or business interest income; (3) the

[444] Section 163(d) applies in the case of a taxpayer other than a corporation. Thus, a corporation has neither investment interest nor investment income within the meaning of section 163(d). Thus, interest income and interest expense of a corporation is properly allocable to a trade or business, unless such trade or business is otherwise explicitly excluded from the application of the provision.

amount of any net operating loss deduction; and (4) any deduction allowable for depreciation, amortization, or depletion.[445] The Secretary may provide other adjustments to the computation of adjusted taxable income.

Floor plan financing interest means interest paid or accrued on floor plan financing indebtedness. Floor plan financing indebtedness means indebtedness used to finance the acquisition of motor vehicles held for sale to retail customers and secured by the inventory so acquired. A motor vehicle means a motor vehicle that is an automobile, a truck, a recreational vehicle, a motorcycle, a boat, farm machinery or equipment, or construction machinery or equipment.

By including business interest income and floor plan financing interest in the limitation, the rule operates to allow floor plan financing interest to be fully deductible and to limit the deduction for net interest expense (less floor plan financing interest) to 30 percent of adjusted taxable income. That is, a deduction for business interest is permitted to the full extent of business interest income and any floor plan financing interest. To the extent that business interest exceeds business interest income and floor plan financing interest, the deduction for the net interest expense is limited to 30 percent of adjusted taxable income.

It is generally intended that, similar to present law, section 163(j) apply after the application of provisions that subject interest to deferral, capitalization, or other limitation. Thus, section 163(j) applies to interest deductions that are deferred, for example under section 163(e) or section 267(a)(3)(B), in the taxable year to which such deductions are deferred. Section 163(j) applies after section 263A is applied to capitalize interest and after, for example, section 265 or section 279 is applied to disallow interest.

Application to passthrough entities

In general

In the case of any partnership, the limitation is applied at the partnership level. Any deduction for business interest is taken into account in determining the nonseparately stated taxable income or loss of the partnership.[446] To prevent double counting, special rules are provided for the determination of the adjusted taxable income of each partner of the partnership. Similarly, to allow for additional interest deduction by a partner in the case of an excess amount of unused adjusted taxable income limitation of the partnership, special rules apply. Similar rules apply with respect to any S corporation and its shareholders.

Double counting rule

The adjusted taxable income of each partner (or shareholder, as the case may be) is determined without regard to such partner's distributive share of the nonseparately stated income or loss of such partnership. In the absence of such a rule, the same dollars of adjusted taxable income of a partnership could generate addi-

[445] Any deduction allowable for depreciation, amortization, or depletion includes any deduction allowable for any amount treated as depreciation, amortization, or depletion under present law.

[446] This amount is the "Ordinary business income or loss" reflected on Form 1065 (U.S. Return of Partnership Income). The partner's distributive share is reflected in Box 1 of Schedule K–1 (Form 1065).

tional interest deductions as the income is passed through to the partners.

Example 1.—ABC is a partnership owned 50–50 by XYZ Corporation and an individual. ABC generates $200 of noninterest income. Its only expense is $60 of business interest. Under the provision the deduction for business interest is limited to 30 percent of adjusted taxable income, that is, 30 percent * $200 = $60. ABC deducts $60 of business interest and reports ordinary business income of $140. XYZ's distributive share of the ordinary business income of ABC is $70. XYZ has net taxable income of zero from its other operations, none of which is attributable to interest income and without regard to its business interest expense. XYZ has business interest expense of $25. In the absence of any special rule, the $70 of taxable income from its interest in ABC would permit the deduction of up to an additional $21 of interest (30 percent * $70 = $21), resulting in a deduction disallowance of only $4. XYZ's $100 share of ABC's adjusted taxable income would generate $51 of interest deductions. If XYZ were instead a passthrough entity, additional deductions could be available at each tier.

The double counting rule provides that XYZ has adjusted taxable income computed without regard to the $70 distributive share of the nonseparately stated income of ABC. As a result, XYZ has adjusted taxable income of $0. XYZ's deduction for business interest is limited to 30 percent * $0 = $0, resulting in a deduction disallowance of $25.

Additional deduction limit

The limit on the amount allowed as a deduction for business interest is increased by a partner's distributive share of the partnership's excess amount of unused adjusted taxable income limitation. The excess amount with respect to any partnership is the excess (if any) of 30 percent of the adjusted taxable income of the partnership over the amount (if any) by which the business interest of the partnership (reduced by floor plan financing interest) exceeds the business interest income of the partnership. This allows a partner of a partnership to deduct more interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest.

Example 2.—The facts are the same as in Example 1 except ABC has only $40 of business interest. As in Example 1, ABC has a limit on its interest deduction of $60. The excess amount for ABC is $60 − $40 = $20. XYZ's distributive share of the excess amount from ABC partnership is $10. XYZ's deduction for business interest is limited to 30 percent of its adjusted taxable income plus its distributive share of the excess amount from ABC partnership (30 percent * $0 + $10 = $10). As a result of the rule, XYZ may deduct $10 of business interest and has an interest deduction disallowance of $15.

Carryforward of disallowed business interest

The amount of any business interest not allowed as a deduction for any taxable year is treated as business interest paid or accrued in the succeeding taxable year. Business interest may be carried forward for up to five years. Carryforwards are determined on a first-in, first-out basis. It is intended that the provision be administered in a way to prevent trafficking in carryforwards.

A coordination rule is provided with the limitation on deduction of interest by domestic corporations in international financial reporting groups.[447] Whichever rule imposes the lower limitation on deduction of business interest with respect to the taxable year (and therefore the greatest amount of interest to be carried forward) governs.

Any carryforward of disallowed business interest is an item taken into account in the case of certain corporate acquisitions described in section 381 and is subject to limitation under section 382.

Exceptions

The limitation does not apply to any taxpayer that meets the $25 million gross receipts test of section 448(c), that is, if the average annual gross receipts for the three-taxable-year period ending with the prior taxable year does not exceed $25 million.[448] Aggregation rules apply to determine the amount of a taxpayer's gross receipts under the gross receipts test of section 448(c).

The trade or business of performing services as an employee is not treated as a trade or business for purposes of the limitation. As a result, for example, the wages of an employee are not counted in the adjusted taxable income of the taxpayer for purposes of determining the limitation.

The limitation does not apply to a real property trade or business as defined in section 469(c)(7)(C). Any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business is not treated as a trade or business for purposes of the limitation. As a result, for example, interest expense paid or incurred in a real property trade or business is not business interest subject to limitation and is generally deductible in the computation of taxable income.

The limitation does not apply to certain regulated public utilities. Specifically, the trade or business of the furnishing or sale of (1) electrical energy, water, or sewage disposal services, (2) gas or steam through a local distribution system, or (3) transportation of gas or steam by pipeline, if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by any agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof is not treated as a trade or business for purposes of the limitation.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

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[447] See section 4302 of the bill (Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group).

[448] In the case of a sole proprietorship, the $25 million gross receipts test is applied as if the sole proprietorship were a corporation or partnership.

2. Modification of net operating loss deduction (sec. 3302 of the bill and sec. 172 of the Code)

PRESENT LAW

A net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income.[449] In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[450] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[451]

Different carryback periods apply with respect to NOLs arising in different circumstances. Extended carryback periods are allowed for NOLs attributable to specified liability losses and certain casualty and disaster losses.[452] Limitations are placed on the carryback of excess interest losses attributable to corporate equity reduction transactions.[453]

REASONS FOR CHANGE

The Committee believes that, except in limited circumstances of disaster losses for farms and small businesses, NOLs should be carried forward, but not back. Further, with the elimination of carrybacks, the Committee believes that NOL carryovers should be adjusted to account for time value of money to preserve its value. The Committee also believes that taxpayers should pay some income tax in years in which the taxpayer has taxable income (determined without regard to the NOL deduction). Therefore, the Committee believes that the NOL deduction should be limited to 90 percent of taxable income (determined without regard to the deduction).

EXPLANATION OF PROVISION

The provision limits the NOL deduction to 90 percent of taxable income (determined without regard to the deduction). Carryovers to other years are adjusted to take account of this limitation, and may be carried forward indefinitely. In addition, NOL carryovers attributable to losses arising in taxable years beginning after December 31, 2017, are increased annually to take into account the time value of money.

The provision repeals the two-year carryback and the special carryback provisions, but provides a one-year carryback in the case of certain disaster losses incurred in the trade or business of farming, or by certain small businesses.[454] For this purpose, small business means a corporation, partnership, or sole proprietorship whose average annual gross receipts for the three taxable-year period ending with such taxable year does not exceed $5,000,000. Aggregation rules apply to determine gross receipts.

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[449] Sec. 172(c).
[450] Sec. 172(b)(1)(A).
[451] Sec. 172(b)(2).
[452] Sec. 172(b)(1)(C) and (E).
[453] Sec. 172(b)(1)(D).
[454] Notwithstanding the amendments made by the provision and section 1304 of the bill (Repeal of deduction for personal casualty losses), the provision retains the present-law three-year carryback for the portion of the NOL for any taxable year which is a net disaster loss to which section 504(b) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (Pub. L. No. 115–63) applies (i.e., a net disaster loss arising from hurricane Harvey, Irma, or Maria).

EFFECTIVE DATE

The provision allowing indefinite carryovers and modifying carrybacks generally applies to losses arising in taxable years beginning after December 31, 2017.[455]

The provision limiting the NOL deduction applies to taxable years beginning after December 31, 2017.

The annual increase in carryover amounts applies to taxable years beginning after December 31, 2017.

3. Like-kind exchanges of real property (sec. 3303 of the bill and sec. 1031 of the Code)

PRESENT LAW

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like kind" which is to be held for productive use in a trade or business or for investment.[456] In general, section 1031 does not apply to any exchange of stock in trade (*i.e.*, inventory) or other property held primarily for sale; stocks, bonds, or notes; other securities or evidences of indebtedness or interest; interests in a partnership; certificates of trust or beneficial interests; or choses in action.[457] Section 1031 also does not apply to certain exchanges involving livestock[458] or foreign property.[459]

For purposes of section 1031, the determination of whether property is of a "like kind" relates to the nature or character of the property and not its grade or quality, *i.e.*, the nonrecognition rules do not apply to an exchange of one class or kind of property for property of a different class or kind (*e.g.*, section 1031 does not apply to an exchange of real property for personal property).[460] The different classes of property are: (1) depreciable tangible personal property;[461] (2) intangible or nondepreciable personal property;[462] and (3) real property.[463] However, the rules with respect to whether real estate is "like kind" are applied more liberally than the rules governing like-kind exchanges of depreciable, intangible, or nondepreciable personal property. For example, improved real estate and unimproved real estate generally are considered to be

[455] See section 3101 of the bill (Increased expensing) for a limitation on the amount of any NOL which may be treated as an NOL carryback in the case of any year which includes any portion of the period beginning September 28, 2017 and ending December 31, 2017.

[456] Sec. 1031(a)(1).

[457] Sec. 1031(a)(2). A chose in action is a right that can be enforced by legal action.

[458] Sec. 1031(e).

[459] Sec. 1031(h).

[460] Treas. Reg. sec. 1.1031(a)–1(b).

[461] For example, an exchange of a personal computer classified under asset class 00.12 of Rev. Proc. 87–56, 1987–2 C.B. 674, for a printer classified under the same asset class of Rev. Proc. 87–56 would be treated as property of a like kind. However, an exchange of an airplane classified under asset class 00.21 of Rev. Proc. 87–56 for a heavy general purpose truck classified under asset class 00.242 of Rev. Proc. 87–56 would not be treated as property of a like kind. See Treas. Reg. sec. 1.1031(a)–2(b)(7).

[462] For example, an exchange of a copyright on a novel for a copyright on a different novel would be treated as property of a like kind. See Treas. Reg. sec. 1.1031(a)–2(c)(3). However, the goodwill or going concern value of one business is not of a like kind to the goodwill or going concern value of a different business. See Treas. Reg. sec. 1.1031(a)–2(c)(2). The Internal Revenue Service ("IRS") has ruled that intangible assets such as trademarks, trade names, mastheads, and customer-based intangibles that can be separately described and valued apart from goodwill qualify as property of a like kind under section 1031. See Chief Counsel Advice 200911006, February 12, 2009.

[463] Treas. Reg. sec. 1.1031(a)–1(b) and (c).

property of a "like kind" as this distinction relates to the grade or quality of the real estate,[464] while depreciable tangible personal properties must be either within the same General Asset Class[465] or within the same Product Class.[466]

The nonrecognition of gain in a like-kind exchange applies only to the extent that like-kind property is received in the exchange. Thus, if an exchange of property would meet the requirements of section 1031, but for the fact that the property received in the transaction consists not only of the property that would be permitted to be exchanged on a tax-free basis, but also other nonqualifying property or money ("additional consideration"), then the gain to the recipient of the other property or money is required to be recognized, but not in an amount exceeding the fair market value of such other property or money.[467] Additionally, any such gain realized on a section 1031 exchange as a result of additional consideration being involved constitutes ordinary income to the extent that the gain is subject to the recapture provisions of sections 1245 and 1250.[468] No losses may be recognized from a like-kind exchange.[469]

If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred. This basis is increased to the extent of any gain recognized as a result of the receipt of other property or money in the like-kind exchange, and decreased to the extent of any money received by the taxpayer.[470] The holding period of qualifying property received includes the holding period of the qualifying property transferred, but the nonqualifying property received is required to begin a new holding period.[471]

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[464] Treas. Reg. sec. 1.1031(a)–1(b).

[465] Treasury Regulation section 1.1031(a)–2(b)(2) provides the following list of General Asset Classes, based on asset classes 00.11 through 00.28 and 00.4 of Rev. Proc. 87–56, 1987–2 C.B. 674: (i) Office furniture, fixtures, and equipment (asset class 00.11), (ii) Information systems (computers and peripheral equipment) (asset class 00.12), (iii) Data handling equipment, except computers (asset class 00.13), (iv) Airplanes (airframes and engines), except those used in commercial or contract carrying of passengers or freight, and all helicopters (airframes and engines) (asset class 00.21), (v) Automobiles, taxis (asset class 00.22), (vi) Buses (asset class 00.23), (vii) Light general purpose trucks (asset class 00.241), (viii) Heavy general purpose trucks (asset class 00.242), (ix) Railroad cars and locomotives, except those owned by railroad transportation companies (asset class 00.25), (x) Tractor units for use over-the-road (asset class 00.26), (xi) Trailers and trailer-mounted containers (asset class 00.27), (xii) Vessels, barges, tugs, and similar water-transportation equipment, except those used in marine construction (asset class 00.28), and (xiii) Industrial steam and electric generation and/or distribution systems (asset class 00.4).

[466] Property within a product class consists of depreciable tangible personal property that is described in a 6-digit product class within Sectors 31, 32, and 33 (pertaining to manufacturing industries) of the North American Industry Classification System ("NAICS"), set forth in Executive Office of the President, Office of Management and Budget, *North American Industry Classification System*, United States, 2002 (NAICS Manual), as periodically updated. Treas. Reg. sec. 1.1031(a)–2(b)(3).

[467] Sec. 1031(b). For example, if a taxpayer holding land A having a basis of $40,000 and a fair market value of $100,000 exchanges the property for land B worth $90,000 plus $10,000 in cash, the taxpayer would recognize $10,000 of gain on the transaction, which would be includable in income. The remaining $50,000 of gain would be deferred until the taxpayer disposes of land B in a taxable sale or exchange.

[468] Secs. 1245(b)(4) and 1250(d)(4). For example, if a taxpayer holding section 1245 property A with an original cost basis of $11,000, an adjusted basis of $10,000, and a fair market value of $15,000 exchanges the property for section 1245 property B with a fair market value of $14,000 plus $1,000 in cash, the taxpayer would recognize $1,000 of ordinary income on the transaction. The remaining $4,000 of gain would be deferred until the taxpayer disposes of section 1245 property B in a taxable sale or exchange.

[469] Sec. 1031(c).

[470] Sec. 1031(d). Thus, in the example noted above, the taxpayer's basis in B would be $40,000 (the taxpayer's transferred basis of $40,000, increased by $10,000 in gain recognized, and decreased by $10,000 in money received).

[471] Sec. 1223(1).

A like-kind exchange also does not require that the properties be exchanged simultaneously. Rather, the property to be received in the exchange must be received not more than 180 days after the date on which the taxpayer relinquishes the original property (but in no event later than the due date (including extensions) of the taxpayer's income tax return for the taxable year in which the transfer of the relinquished property occurs). In addition, the taxpayer must identify the property to be received within 45 days after the date on which the taxpayer transfers the property relinquished in the exchange.[472]

The Treasury Department has issued regulations[473] and revenue procedures[474] providing guidance and safe harbors for taxpayers engaging in deferred like-kind exchanges.

REASONS FOR CHANGE

The definition of like-kind property has been modified legislatively over the years to address issues relating to targeted types of property. With the provisions in the bill of increased and expanded expensing under sections 168(k) and 179 for tangible personal property and certain building improvements,[475] the Committee believes that section 1031 should be limited to exchanges of real property not held primarily for sale.

EXPLANATION OF PROVISION

The provision modifies the provision providing for nonrecognition of gain in the case of like-kind exchanges by limiting its application to real property that is not held primarily for sale.[476]

EFFECTIVE DATE

The provision generally applies to exchanges completed after December 31, 2017. However, an exception is provided for any exchange if the property disposed of by the taxpayer in the exchange is disposed of on or before December 31, 2017, or the property received by the taxpayer in the exchange is received on or before such date.

4. Revision of treatment of contributions to capital (sec. 3304 of the bill and sec. 118 of the Code)

PRESENT LAW

The gross income of a corporation does not include any contribution to its capital.[477] For purposes of this rule, a contribution to the

[472] Sec. 1031(a)(3).
[473] Treas. Reg. sec. 1.1031(k)–1(a) through (o).
[474] See Rev. Proc. 2000–37, 2000–40 I.R.B. 308, as modified by Rev. Proc. 2004–51, 2004–33 I.R.B. 294.
[475] See sections 3101 (Increased expensing) and 3201 (Expansion of section 179 expensing) of the bill.
[476] It is intended that real property eligible for like-kind exchange treatment under present law will continue to be eligible for like-kind exchange treatment under the provision. For example, a like-kind exchange of real property includes an exchange of shares in a mutual ditch, reservoir, or irrigation company described in section 501(c)(12)(A) if at the time of the exchange such shares have been recognized by the highest court or statute of the State in which the company is organized as constituting or representing real property or an interest in real property. Similarly, improved real estate and unimproved real estate are generally considered to be property of a like kind (see Treas. Reg. sec. 1.1031(a)–1(b)).
[477] Sec. 118(a).

capital of a corporation does not include any contribution in aid of construction or any other contribution from a customer or potential customer.[478] A special rule allows certain contributions in aid of construction received by a regulated public utility that provides water or sewerage disposal services to be treated as a tax-free contribution to the capital of the utility.[479] No deduction or credit is allowed for, or by reason of, any expenditure that constitutes a contribution that is treated as a tax-free contribution to the capital of the utility.[480]

If property is acquired by a corporation as a contribution to capital and is not contributed by a shareholder as such, the adjusted basis of the property is zero.[481] If the contribution consists of money, the corporation must first reduce the basis of any property acquired with the contributed money within the following 12-month period, and then reduce the basis of other property held by the corporation.[482] Similarly, the adjusted basis of any property acquired by a utility with a contribution in aid of construction is zero.[483]

REASONS FOR CHANGE

The Committee believes that a contribution to corporation's capital is properly treated as income to the recipient unless the contributor receives in exchange an ownership interest of commensurate value to the contribution. The Committee also believes that removing a special rule that applies only to certain contributions to a corporation by nonshareholders helps achieve the goal of similar treatment of similarly situated taxpayers. The Committee further believes that treating contributions to capital by nonshareholders as income to the corporation will remove a Federal tax subsidy for State and local governments to offer incentives to businesses as a way of encouraging them to locate operations in a particular jurisdiction. If taxpayers in a particular State or locality wish to provide such financial inducements to businesses, they should be able to do so, but they should bear the cost of such financial inducements without passing on a portion of those costs to all Federal taxpayers.

EXPLANATION OF PROVISION

The provision repeals the provision of the Internal Revenue Code under which, generally, a corporation's gross income does not include contributions of capital to the corporation.

The provision provides that a contribution to capital, other than a contribution of money or property made in exchange for stock of a corporation or any interest in an entity, is included in gross income of the corporation. For example, a contribution of municipal land by a municipality that is not in exchange for stock (or for a partnership interest or other interest) of equivalent value is considered a contribution to capital that is includable in gross income. By contrast, a municipal tax abatement for locating a business in a particular municipality is not considered a contribution to capital.

[478] Sec. 118(b).
[479] Sec. 118(c)(1).
[480] Sec. 118(c)(4).
[481] Sec. 362(c)(1).
[482] Sec. 362(c)(2). See also Treas. Reg. sec. 1.362–2.
[483] Sec. 118(c)(4).

The provision further provides that a contribution of capital in exchange for stock is not includible in the gross income of the corporation to the extent that the fair market value of any money or other property contributed does not exceed the fair market value of stock received. It is intended that, for this purpose, the fair market value of any property contributed is calculated net of any liabilities to which the property is subject and net of any liabilities or obligations of the transferor assumed or taken subject to by the entity in connection with the transaction. When valuing stock or equity received, taxpayers may disregard discounts for lack of control and the effect of limited liquidity on valuation.

The provision does not change the application of the meaningless gesture doctrine, described in *Lessinger* v. *Commissioner*, 872 F.2d 519 (2d. Cir. 1989) and related cases, as well as in administrative guidance.[484] Thus, under the provision, whether incremental shares of stock are issued when the existing shareholder or shareholders of a corporation make a pro-rata contribution to the capital of the corporation is not determinative of whether the contribution is included in income of the corporation.

The fair market value requirement generally will be satisfied in any arm's length transaction in which stock is issued in consideration for cash. Thus, for example, in a public offering, if the price of the stock was determined on an arm's length basis, the fact the stock trades immediately after its issuance at a price below the issue price will not result in contribution to capital treatment.

Finally, the provision provides rules clarifying the contributee's basis in the property contributed.

EFFECTIVE DATE

The provision applies to contributions made, and transactions entered into, after the date of enactment.

5. Repeal of deduction for local lobbying expenses (sec. 3305 of the bill and sec. 162(e) of the Code)

PRESENT LAW

In general

A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[485] However, section 162(e) denies a deduction for amounts paid or incurred in connection with (1) influencing legislation,[486] (2) participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office, (3) any attempt to influence the general public, or segments thereof, with respect to elections, legislative matters, or referendums, or (4) any

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[484] Rev. Rul. 64–155, 1964–1 CB 138.

[485] Sec. 162(a).

[486] The term "influencing legislation" means any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation. The term "legislation" includes actions with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. Secs. 162(e)(4) and 4911(e)(2).

direct communication with a covered executive branch official[487] in an attempt to influence the official actions or positions of such official. Expenses paid or incurred in connection with lobbying and political activities (such as research for, or preparation, planning, or coordination of, any previously described activity) also are not deductible.[488]

Exceptions

Local legislation

Notwithstanding the above, a deduction is allowed for ordinary and necessary expenses incurred in connection with any legislation of any local council or similar governing body ("local legislation").[489] With respect to local legislation, the exception permits a deduction for amounts paid or incurred in carrying on any trade or business (1) in direct connection with appearances before, submission of statements to, or sending communications to the committees or individual members of such council or body with respect to legislation or proposed legislation of direct interest to the taxpayer, or (2) in direct connection with communication of information between the taxpayer and an organization of which the taxpayer is a member with respect to any such legislation or proposed legislation which is of direct interest to the taxpayer and such organization, and (3) that portion of the dues paid or incurred with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the activities described in (1) or (2) carried on by such organization.[490]

For purposes of this exception, legislation of an Indian tribal government is treated in the same manner as local legislation.[491]

De minimis

For taxpayers with $2,000 or less of in-house expenditures related to lobbying and political activities, a de minimis exception is provided that permits a deduction.[492]

REASONS FOR CHANGE

The Committee believes that Federal tax law should not draw a distinction between the deductibility of local and non-local lobbying expenses. The Committee further believes that ending the deductibility of local lobbying expenses eliminates a Federal tax subsidy for efforts to influence local legislation. Finally, the Committee believes that elimination of this distinction furthers its general goal of simplification of Federal tax law.

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[487] The term "covered executive branch official" means (1) the President, (2) the Vice President, (3) any officer or employee of the White House Office of the Executive Office of the President, and the two most senior level officers of each of the other agencies in such Executive Office, (4) any individual servicing in a position in level I of the Executive Schedule under section 5312 of title 5, United States Code, (5) any other individual designated by the President as having Cabinet-level status, and (6) any immediate deputy of an individual described in (4) or (5). Sec. 162(e)(6).

[488] Sec. 162(e)(5)(C).

[489] Sec. 162(e)(2)(A).

[490] Sec. 162(e)(2)(B).

[491] Sec. 162(e)(7).

[492] Sec. 162(e)(5)(B).

EXPLANATION OF PROVISION

The provision repeals the exception for amounts paid or incurred related to lobbying local councils or similar governing bodies, including Indian tribal governments. Thus, the general disallowance rules applicable to lobbying and political expenditures will apply to costs incurred related to such local legislation.

EFFECTIVE DATE

The provision applies to amounts paid or incurred after December 31, 2017.

6. Repeal of deduction for income attributable to domestic production activities (sec. 3306 of the bill and sec. 199 of the Code)

PRESENT LAW

Section 199 provides a deduction from taxable income (or, in the case of an individual, adjusted gross income [493]) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income (determined without regard to the section 199 deduction) for the taxable year.[494] For corporations subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.[495] A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.[496]

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property [497] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; [498] (2) any sale, exchange, or other disposition, or any lease,

[493] For this purpose, adjusted gross income is determined after application of sections 86, 135, 137, 219, 221, 222, and 469, without regard to the section 199 deduction. Sec. 199(d)(2).

[494] Sec. 199(a). In the case of oil related qualified production activities income, the deduction from taxable income is equal to six percent of the lesser of the taxpayer's oil related qualified production activities income, qualified production activities income, or taxable income. Sec. 199(d)(9).

[495] This example assumes the deduction does not exceed the wage limitation discussed below.

[496] Sec. 199(c)(1). In computing qualified production activities income, the domestic production activities deduction itself is not an allocable deduction. Sec. 199(c)(1)(B)(ii). See Treas. Reg. secs. 1.199–1 through 1.199–9 where the Secretary has prescribed rules for the proper allocation of items of income, deduction, expense, and loss for purposes of determining qualified production activities income.

[497] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings. Sec. 199(c)(5).

[498] When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia. Sec. 7701(a)(9). A special rule for determining domestic production gross receipts, however, provides that for taxable years beginning after December 31, 2005, and before January 1, 2018, in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations for such taxable year. Secs. 199(d)(8)(A) and (C), as extended by section 4401 of the bill (Extension of

Continued

rental, or license, of qualified film[499] produced by the taxpayer; (3) any sale, exchange, or other disposition, or any lease, rental, or license, of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.[500]

The amount of the deduction for a taxable year is limited to 50 percent of the W–2 wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[501]

REASONS FOR CHANGE

The Committee believes the reduction in corporate rate and creation of a maximum rate on business income of individuals will enhance the ability of all domestic businesses to compete in the global marketplace and enable small businesses to maintain their position as the primary source of new jobs in this country. Therefore, while the Committee believes that the deduction for income attributable to domestic production activities has generally helped domestic manufacturing firms by improving the cash flow of domestic manufacturers and making investments in domestic manufacturing facilities more attractive, there is no longer a need for such deduction. Finally, the Committee believes that elimination of deduction for income attributable to domestic production activities furthers the Committee's general goal of simplification of the tax code.

EXPLANATION OF PROVISION

The provision repeals section 199 for taxable years beginning after December 31, 2017.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

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deduction allowable with respect to income attributable to domestic production activities in Puerto Rico). In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico. Sec. 199(d)(8)(B).

[499] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers. Sec. 199(c)(6).

[500] Sec. 199(c)(4)(A).

[501] Sec. 199(b)(1). For purposes of the provision, "W–2 wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year. Elective deferrals include elective deferrals as defined in section 402(g)(3), amounts deferred under section 457, and designated Roth contributions as defined in section 402A. See sec. 199(b)(2)(A). The wage limitation for qualified films includes any compensation for services performed in the United States by actors, production personnel, directors, and producers and is not restricted to W–2 wages. Sec. 199(b)(2)(D).

7. Entertainment, etc. expenses (sec. 3307 of the bill and sec. 274 of the Code)

PRESENT LAW

In general

No deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement, or recreation ("entertainment"), unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or (2) a facility (*e.g.*, an airplane) used in connection with such activity.[502] If the taxpayer establishes that entertainment expenses are directly related to (or associated with) the active conduct of its trade or business, the deduction generally is limited to 50 percent of the amount otherwise deductible.[503] Similarly, a deduction for any expense for food or beverages generally is limited to 50 percent of the amount otherwise deductible.[504] In addition, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation, or other social purpose.[505]

There are a number of exceptions to the general rule disallowing deduction of entertainment expenses and the rules limiting deductions to 50 percent of the otherwise deductible amount. Under one such exception, those rules do not apply to expenses for goods, services, and facilities to the extent that the expenses are reported by the taxpayer as compensation and as wages to an employee.[506] Those rules also do not apply to expenses for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient who is not an employee (*e.g.*, a nonemployee director) as compensation for services rendered or as a prize or award.[507] The exceptions apply only to the extent that amounts are properly reported by the company as compensation and wages or otherwise includible in income. In no event can the amount of the deduction exceed the amount of the taxpayer's actual cost, even if a greater amount (*i.e.*, fair market value) is includible in income.[508]

Those deduction disallowance rules also do not apply to expenses paid or incurred by the taxpayer, in connection with the performance of services for another person (other than an employer), under a reimbursement or other expense allowance arrangement if the taxpayer accounts for the expenses to such person.[509] Another exception applies for expenses for recreational, social, or similar activities primarily for the benefit of employees other than certain owners and highly compensated employees.[510] An exception applies also to the 50 percent deduction limit for food and beverages provided to crew members of certain commercial vessels and certain oil or gas platform or drilling rig workers.[511]

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[502] Sec. 274(a)(1).
[503] Sec. 274(n)(1)(B).
[504] Sec. 274(n)(1)(A).
[505] Sec. 274(a)(3).
[506] Sec. 274(e)(2)(A). See below for a discussion of the recent modification of this rule for certain individuals.
[507] Sec. 274(e)(9).
[508] Treas. Reg. sec. 1.162–25T(a).
[509] Sec. 274(e)(3).
[510] Sec. 274(e)(4).
[511] Sec. 274(n)(2)(E).

Expenses treated as compensation

Except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.[512] In general, an employee (or other service provider) must include in gross income the amount by which the fair market value of a fringe benefit exceeds the sum of the amount (if any) paid by the individual and the amount (if any) specifically excluded from gross income.[513] Treasury regulations provide detailed rules regarding the valuation of certain fringe benefits, including flights on an employer-provided aircraft. In general, the value of a noncommercial flight generally is determined under the base aircraft valuation formula, also known as the Standard Industry Fare Level formula or "SIFL."[514] If the SIFL valuation rules do not apply, the value of a flight on an employer-provided aircraft generally is equal to the amount that an individual would have to pay in an arm's-length transaction to charter the same or a comparable aircraft for that period for the same or a comparable flight.[515]

In the context of an employer providing an aircraft to employees for nonbusiness (*e.g.*, vacation) flights, the exception for expenses treated as compensation has been interpreted as not limiting the company's deduction for expenses attributable to the operation of the aircraft to the amount of compensation reportable to its employees.[516] The result of that interpretation is often a deduction several times larger than the amount required to be included in income. Further, in many cases, the individual including amounts attributable to personal travel in income directly benefits from the enhanced deduction, resulting in a net deduction for the personal use of the company aircraft.

The exceptions for expenses treated as compensation or otherwise includible income were subsequently modified in the case of specified individuals such that the exceptions apply only to the extent of the amount of expenses treated as compensation or includible in income of the specified individual.[517] Specified individuals are individuals who, with respect to an employer or other service recipient (or a related party), are subject to the requirements of section 16(a) of the Securities Exchange Act of 1934, or would be subject to such requirements if the employer or service recipient (or related party) were an issuer of equity securities referred to in section 16(a).[518]

As a result, in the case of specified individuals, no deduction is allowed with respect to expenses for (1) a nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility (*e.g.*, an airplane) used in connection with such activity to the extent that such expenses exceed the amount treated as compensation or includible in income to the specified individual. For example, a company's deduction attributable to aircraft operating costs and other expenses for a specified individual's vacation use of a company aircraft is limited to the amount reported as com-

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[512] Sec. 61(a)(1).
[513] Treas. Reg. sec. 1.61–21(b)(1).
[514] Treas. Reg. sec. 1.61–21(g)(5).
[515] Treas. Reg. sec. 1.61–21(b)(6).
[516] *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 197 (2000), aff'd, 255 F.3d 495 (8th Cir. 2001).
[517] Sec. 274(e)(2)(B)(i). See also Treas. Reg. sec. 1.274–9(a).
[518] Sec. 274(e)(2)(B)(ii). See also Treas. Reg. sec. 1.274–9(b).

pensation to the specified individual. However, in the case of other employees or service providers, the company's deduction is not limited to the amount treated as compensation or includible in income.[519]

Excludable fringe benefits

Certain employer-provided fringe benefits are excluded from an employee's gross income and wages for employment tax purposes, including de minimis fringes and qualified transportation fringes.[520] A de minimis fringe generally means any property or service the value of which is (taking into account the frequency with which similar fringes are provided by the employer) so small as to make accounting for it unreasonable or administratively impracticable.[521] Qualified transportation fringes include qualified parking (*i.e.,* on or near the employer's business premises or on or near a location from which the employee commutes to work by public transit), transit passes, vanpool benefits, and qualified bicycle commuting reimbursements.[522] On-premises athletic facilities are gyms or other athletic facilities located on the employer's premises, operated by the employer, and substantially all the use of which is by employees of the employer, their spouses, and their dependent children.[523]

REASONS FOR CHANGE

The Committee believes that the difficulty in determining whether entertainment expenses are directly related to, or associated with, a trade or business creates uncertainty for taxpayers and the potential for significant abuse. The Committee therefore believes that a tax deduction for entertainment-related expenses should be permitted only to the extent such items are reported as employee compensation. The Committee also aligns the treatment of the employer's deduction for transportation and gym benefits, and amenities provided to an employee that are primarily personal in nature and not directly related to a trade or business, with other similar taxable items.

EXPLANATION OF PROVISION

The provision provides that no deduction is allowed with respect to (1) an activity generally considered to be entertainment, amusement or recreation, (2) membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, (3) a de minimis fringe that is primarily personal in nature and involving property or services that are not directly related to the taxpayer's trade or business, (4) a facility or portion thereof used in connection with any of the above items, (5) a qualified transportation fringe, including costs of operating a facility used for qualified parking, and (6) an on-premises athletic facility provided by an employer to its employees, including costs of operating such

[519] See Treas. Reg. sec. 1.274–10(a)(2).

[520] Secs. 132(a), 3121(a)(20), 3231(e)(5), 3306(b)(16), and 3401(a)(19).

[521] Sec. 132(e)(1). Examples include occasional personal use of an employer's copying machine, occasional parties or meals for employees and their guests, local telephone calls, and coffee, doughnuts and soft drinks. Treas. Reg. sec. 1.132–6(e)(1).

[522] Sec. 132(f)(1), (5). The qualified transportation fringe exclusions are subject to monthly limits. Sec. 132(f)(2).

[523] Section 132(j)(4).

a facility. Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business (and the related rule applying a 50 percent limit to such deductions). The provision also repeals the present-law exception for recreational, social, or similar activities primarily for the benefit of employees. However, taxpayers may still, generally, deduct 50 percent of the food and beverage expenses associated with operating their trade or business (*e.g.*, meals consumed by employees on work travel).

Under the provision, in the case of all individuals (not just specified individuals), the exceptions to the general entertainment expense disallowance rule for expenses treated as compensation or includible in income apply only to the extent of the amount of expenses treated as compensation or includible in income. Thus, under those exceptions, no deduction is allowed with respect to expenses for (1) a nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility (*e.g.*, an airplane) used in connection with such activity to the extent that such expenses exceed the amount treated as compensation or includible in income. As under present law, the exceptions apply only if amounts are properly reported by the company as compensation and wages or otherwise includible in income.

The provision amends the present-law exception for reimbursed expenses. The provision disallows a deduction for amounts paid or incurred by a taxpayer in connection with the performance of services for another person (other than an employee) under a reimbursement or other expense allowance arrangement if the person for whom the services are performed is a tax-exempt entity[524] or the arrangement is designated by the Secretary as having the effect of avoiding the 50 percent deduction disallowance.

The provision clarifies that the exception to the 50 percent deduction limit for food or beverages applies to any expense excludible from the gross income of the recipient related to meals furnished for the convenience of the employer. The provision thereby repeals as deadwood the special exceptions for food or beverages provided to crew members of certain commercial vessels and certain oil or gas platform or drilling rig workers.

EFFECTIVE DATE

The provision applies to amounts paid or incurred after December 31, 2017.

[524] As defined in section 168(h)(2)(A), *i.e.*, Federal, State and local government entities, organizations (other than certain cooperatives) exempt from income tax, any foreign person or entity, and any Indian tribal government.

8. Unrelated business taxable income increased by amount of certain fringe benefit expenses for which deduction is disallowed (sec. 3308 of the bill and sec. 512 of the Code)

PRESENT LAW

Tax exemption for certain organizations

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

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[525] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990–T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing its exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[526] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

An organization determines its unrelated business taxable income by subtracting from its gross unrelated business income deductions directly connected with the unrelated trade or business.[527] Under regulations, in determining unrelated business taxable income, an organization that operates multiple unrelated trades or businesses aggregates income from all such activities and subtracts from the aggregate gross income the aggregate of deductions.[528] As a result, an organization may use a loss from one unrelated trade or business to offset gain from another, thereby reducing total unrelated business taxable income.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts); (2) qualified pension, profit-sharing, and

[525] Secs. 511–514.
[526] Treas. Reg. sec. 1.501(c)(3)–1(e).
[527] Sec. 512(a).
[528] Treas. Reg. sec. 1.512(a)–1(a).

stock bonus plans described in section 401(a); and (3) certain State colleges and universities.[529]

Exclusions from Unrelated Business Taxable Income

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[530] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[531] Other exemptions from UBIT are provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

REASONS FOR CHANGE

As part of its broader tax reform effort, the Committee believes that certain nontaxable fringe benefits should not be deductible by employers if not includible in income of employees. The Committee believes that aligning the tax treatment between for-profit and tax-exempt employers with respect to nontaxable transportation and gym benefits provided to employees will make the tax system simpler and fairer for all businesses. In addition, broadening the tax base will allow for lower tax rates that will benefit all taxpayers.

EXPLANATION OF PROVISION

Under the provision, unrelated business taxable income includes any expenses paid or incurred by a tax exempt organization for qualified transportation fringe benefits (as defined in section 132(f)), a parking facility used in connection with qualified parking (as defined in section 132(f)(5)(C)), or any on-premises athletic facility (as defined in section 132(j)(4)(B)), provided such amounts are not deductible under section 274.

EFFECTIVE DATE

The provision is effective for amounts paid or incurred after December 31, 2017.

9. limitation on deduction for FDIC premiums (sec. 3309 of the bill and sec. 162 of the Code)

PRESENT LAW

Corporations organized under the laws of any of the 50 States (and the District of Columbia) generally are subject to the U.S. corporate income tax on their worldwide taxable income. The taxable

[529] Sec. 511(a)(2).
[530] Secs. 511–514.
[531] Sec. 512(b)(13).

income of a C corporation[532] generally comprises gross income less allowable deductions. A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[533]

Corporations that make a valid election pursuant to section 1362 of subchapter S of the Code, referred to as S corporations, generally are not subject to corporate-level income tax on its items of income and loss. Instead, an S corporation passes through to shareholders its items of income and loss. The shareholders separately take into account their shares of these items on their individual income tax returns.

Banks, thrifts, and credit unions

In general

Financial institutions are subject to the same Federal income tax rules and rates as are applied to other corporations or entities, with specified exceptions.

C corporation banks and thrifts

A bank is generally taxed for Federal income tax purposes as a C corporation. For this purpose a bank generally means a corporation, a substantial portion of whose business is receiving deposits and making loans and discounts, or exercising certain fiduciary powers.[534] A bank for this purpose generally includes domestic building and loan associations, mutual stock or savings banks, and certain cooperative banks that are commonly referred to as thrifts.[535]

S corporation banks

A bank is generally eligible to elect S corporation status under section 1362, provided it meets the other requirements for making this election and it does not use the reserve method of accounting for bad debts as described in section 585.[536]

Special bad debt loss rules for small banks

Section 166 provides a deduction for any debt that becomes worthless (wholly or partially) within a taxable year. The reserve

[532] Corporations subject to tax are commonly referred to as C corporations after subchapter C of the Code, which sets forth corporate tax rules. Certain specialized entities that invest primarily in real estate related assets (real estate investment trusts) or in stock and securities (regulated investment companies) and that meet other requirements, generally including annual distribution of 90 percent of their income, are allowed to deduct their distributions to shareholders, thus generally paying little or no corporate-level tax despite otherwise being subject to subchapter C.

[533] Sec. 162(a). However, certain exceptions apply. No deduction is allowed for (1) any charitable contribution or gift that would be allowable as a deduction under section 170 were it not for the percentage limitations, the dollar limitations, or the requirements as to the time of payment, set forth in such section; (2) any illegal bribe, illegal kickback, or other illegal payment; (3) certain lobbying and political expenditures; (4) any fine or similar penalty paid to a government for the violation of any law; (5) two-thirds of treble damage payments under the antitrust laws; (6) certain foreign advertising expenses; (7) certain amounts paid or incurred by a corporation in connection with the reacquisition of its stock or of the stock of any related person; or (8) certain applicable employee remuneration.

[534] Sec. 581. See also Treas. Reg. sec. 1.581–1(a).

[535] While the general principles for determining the taxable income of a corporation are applicable to a mutual savings bank, a building and loan association, and a cooperative bank, there are certain exceptions and special rules for such institutions. Treas. Reg. sec. 1.581–2(a).

[536] Sec. 1361(b)(2)(A).

method of accounting for bad debts, repealed in 1986[537] for most taxpayers, is allowed under section 585 for any bank (as defined in section 581) other than a large bank. For this purpose, a bank is a large bank if, for the taxable year (or for any preceding taxable year after 1986), the average adjusted basis of all its assets (or the assets of the controlled group of which it is a member) exceeds $500 million. Deductions for reserves are taken in lieu of a worthless debt deduction under section 166. Accordingly, a small bank is able to take deductions for additions to a bad debt reserve. Additions to the reserve are determined under an experience method that generally looks to the ratio of (1) the total bad debts sustained during the taxable year and the five preceding taxable years to (2) the sum of the loans outstanding at the close of such taxable years.[538]

Credit unions

Credit unions are exempt from Federal income taxation.[539] The exemption is based on their status as not-for-profit mutual or cooperative organizations (without capital stock) operated for the benefit of their members, who generally must share a common bond. The definition of common bond has been expanded to permit greater use of credit unions.[540] While significant differences between the rules under which credit unions and banks operate have existed in the past, most of those differences have disappeared over time.[541]

FDIC premiums

The Federal Deposit Insurance Corporation ("FDIC") provides deposit insurance for banks and savings institutions. To maintain its status as an insured depository institution, a bank must pay semiannual assessments into the deposit insurance fund ("DIF"). Assessments for deposit insurance are treated as ordinary and necessary business expenses. These assessments, also known as premiums, are deductible once the all events test for the premium is satisfied.[542]

REASONS FOR CHANGE

The Committee believes that this provision is necessary to correct for the fact that, when the FDIC determines the assessments necessary to maintain an adequate balance in the DIF, it does so on a pretax 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.

[537] Tax Reform Act of 1986, Pub. L. No. 99–514.

[538] Sec. 585(b)(2).

[539] Sec. 501(c)(14)(A). For a discussion of the history of and reasons for Federal tax exemption, see United States Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions*, Report 3070, January 15, 2001, available at https://www.treasury.gov/press-center/press-releases/Documents/report30702.doc.

[540] The Credit Union Membership Access Act, Pub. L. No. 105–219, allows multiple common bond credit unions. The legislation in part responds to *National Credit Union Administration v. First National Bank & Trust Co.*, 522 U.S. 479 (1998), which interpreted the permissible membership of tax-exempt credit unions narrowly.

[541] The Treasury Department has concluded that any remaining regulatory differences do not raise competitive equity concerns between credit unions and banks. United States Department of the Treasury, *Comparing Credit Unions with Other Depository Institutions*, Report 3070, January 15, 2001, p. 2, available at https://www.treasury.gov/press-center/press-releases/Documents/report30702.doc.

[542] Technical Advice Memorandum 199924060, March 5, 1999, and Rev. Rul. 80–230, 1980–2 C.B. 169, 1980.

EXPLANATION OF PROVISION

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

FDIC premium means any assessment imposed under section 7(b) of the Federal Deposit Insurance Act.[543] The term total consolidated assets has the meaning given such term under section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[544]

For purposes of determining a taxpayer's total consolidated assets, members of an expanded affiliated group are treated as a single taxpayer. An expanded affiliated group means an affiliated group as defined in section 1504(a), determined by substituting "more than 50 percent" for "at least 80 percent" each place it appears and without regard to the exceptions from the definition of includible corporation for insurance companies and foreign corporations. A partnership or any other entity other than a corporation is treated as a member of an expanded affiliated group if such entity is controlled by members of such group.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

10. Repeal of rollover of publicly traded securities gain into specialized small business investment companies (sec. 3310 of the bill and sec. 1044 of the Code)

PRESENT LAW

A corporation or individual may elect to roll over tax-free any capital gain realized on the sale of publicly-traded securities to the extent of the taxpayer's cost of purchasing common stock or a partnership interest in a specialized small business investment company within 60 days of the sale.[545] The amount of gain that an individual may elect to roll over under this provision for a taxable year is limited to (1) $50,000 or (2) $500,000 reduced by the gain previously excluded under this provision.[546] For corporations, these limits are $250,000 and $1 million, respectively.[547]

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the election described above to roll over tax-free

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[543] 12 U.S.C. sec. 1817(b).
[544] Pub. L. No. 111–203.
[545] Sec. 1044(a).
[546] Sec. 1044(b)(1).
[547] Sec. 1044(b)(2).

capital gain realized on the sale of publicly-traded securities, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is a necessary part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the election described above to roll over tax-free capital gain realized on the sale of publicly-traded securities.

EFFECTIVE DATE

The provision applies to sales after December 31, 2017.

11. Certain self-created property not treated as a capital asset (sec. 3311 of the bill and sec. 1221 of the Code)

PRESENT LAW

In general, property held by a taxpayer (whether or not connected with his trade or business) is considered a capital asset.[548] Certain assets, however, are specifically excluded from the definition of capital asset. Such excluded assets are: inventory property, property of a character subject to depreciation (including real property),[549] certain self-created intangibles, accounts or notes receivable acquired in the ordinary course of business (*e.g.*, for providing services or selling property), publications of the U.S. Government received by a taxpayer other than by purchase at the price offered to the public, commodities derivative financial instruments held by a commodities derivatives dealer unless established to the satisfaction of the Secretary that any such instrument has no connection to the activities of such dealer as a dealer and clearly identified as such before the close of the day on which it was acquired, originated, or entered into, hedging transactions clearly identified as such, and supplies regularly used or consumed by the taxpayer in the ordinary course of a trade or business of the taxpayer.[550]

Self-created intangibles subject to the exception are copyrights, literary, musical, or artistic compositions, letters or memoranda, or similar property which is held either by the taxpayer who created the property, or (in the case of a letter, memorandum, or similar property) a taxpayer for whom the property was produced.[551] For the purpose of determining gain, a taxpayer with a substituted or transferred basis from the taxpayer who created the property, or for whom the property was created, also is subject to the exception.[552] However, a taxpayer may elect to treat musical compositions and copyrights in musical works as capital assets.[553]

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[548] Sec. 1221(a).

[549] The net gain from the sale, exchange, or involuntary conversion of certain property used in the taxpayer's trade or business (in excess of depreciation recapture) is treated as long-term capital gain. Sec. 1231. However, net gain from such property is treated as ordinary income to the extent that losses from such property in the previous five years were treated as ordinary losses. Sec. 1231(c).

[550] Sec. 1221(a)(1)–(8).

[551] Sec. 1221(a)(3)(A) and (B).

[552] Sec. 1221(a)(3)(C).

[553] Sec. 1221(b)(3). Thus, if a taxpayer who owns musical compositions or copyrights in musical works that the taxpayer created (or if a taxpayer to which the musical compositions or copyrights have been transferred by the works' creator in a substituted basis transaction) elects the

Since the intent of Congress is that profits and losses arising from everyday business operations be characterized as ordinary income and loss, the general definition of capital asset is narrowly applied and the categories of exclusions are broadly interpreted.[554]

REASONS FOR CHANGE

The rationale underlying the treatment of a copyright, artistic work, and similar property in the hands of the person who created it (or in the possession of a person who received the property as a gift from the person who created it) is that the holder of the property is, in effect, engaged in the business of creating and selling the copyright or similar property (or is selling the property created by the personal efforts of another who gave the individual the property). Thus, gain arising from the sale of such property is treated as ordinary income derived as compensation for personal services rendered by the person (or the contributor), rather than as capital gain from the sale of property held as a capital asset. The Committee believes that a patent, invention, model or design, and a secret formula or process are essentially similar to copyrights and similar property created by the personal efforts of the taxpayer (or of the person who gave the property to the taxpayer), and should, therefore, be classified in the same manner for purposes of the tax law. The Committee believes that one who sells a patent, invention, model or design, or secret formula or process created by or for the person should not be treated as receiving capital gain on the sale when the product being sold is, in effect, the result of personal efforts.

EXPLANATION OF PROVISION

This provision amends section 1221(a)(3), resulting in the exclusion of a patent, invention, model or design (whether or not patented), and a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) from the definition of a "capital asset." Thus, gains or losses from the sale or exchange of a patent, invention, model or design (whether or not patented), or a secret formula or process which is held either by the taxpayer who created the property or a taxpayer with a substituted or transferred basis from the taxpayer who created the property (or for whom the property was created) will not receive capital gain treatment.

EFFECTIVE DATE

The provision applies to dispositions after December 31, 2017.

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application of this provision, gain from a sale of the compositions or copyrights is treated as capital gain, not ordinary income.

[554] *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52 (1955).

12. Repeal of special rule for sale or exchange of patents (sec. 3312 of the bill and sec. 1235 of the Code)

PRESENT LAW

Section 1235 provides that a transfer[555] of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than one year, regardless of whether or not payments in consideration of such transfer are (1) payable periodically over a period generally conterminous with the transferee's use of the patent, or (2) contingent on the productivity, use, or disposition of the property transferred.[556]

A holder is defined as (1) any individual whose efforts created such property, or (2) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither the employer of such creator nor related (as defined) to such creator.[557]

REASONS FOR CHANGE

The Committee believes that certain self-created intangibles should not be treated as capital assets and that income derived from such intangibles should be ordinary in character. The special rule for the sale or exchange of patents, which treats the gain as capital, is inconsistent with that belief.

EXPLANATION OF PROVISION

The provision repeals section 1235. Thus, the holder of a patented invention may not transfer his or her rights to the patent and treat amounts received as proceeds from the sale of a capital asset. It is intended that the determination of whether a transfer is a sale or exchange of a capital asset that produces capital gain, or a transaction that produces ordinary income, will be determined under generally applicable principles.[558]

EFFECTIVE DATE

The provision applies to dispositions after December 31, 2017.

13. Repeal of technical termination of partnerships (sec. 3313 of the bill and sec. 708(b) of the Code)

PRESENT LAW

A partnership is considered as terminated under specified circumstances.[559] Special rules apply in the case of the merger, consolidation, or division of a partnership.[560]

[555] A transfer by gift, inheritance, or devise is not included.
[556] Sec. 1235(a).
[557] Sec. 1235(b).
[558] See also section 3311 of the bill (Certain self-created property not treated as a capital asset).
[559] Sec. 708(b)(1).
[560] Sec. 708(b)(2). Mergers, consolidations, and divisions of partnerships take either an assets-over form or an assets-up form pursuant to Treas. Reg. sec. 1.708–1(c).

A partnership is treated as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.[561]

A partnership is also treated as terminated if within any 12-month period, there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.[562] This is sometimes referred to as a technical termination. Under regulations, the technical termination gives rise to a deemed contribution of all the partnership's assets and liabilities to a new partnership in exchange for an interest in the new partnership, followed by a deemed distribution of interests in the new partnership to the purchasing partners and the other remaining partners.[563]

The effect of a technical termination is not necessarily the end of the partnership's existence, but rather the termination of some tax attributes. Upon a technical termination, the partnership's taxable year closes, potentially resulting in short taxable years.[564] Partnership-level elections generally cease to apply following a technical termination.[565] A technical termination generally results in the restart of partnership depreciation recovery periods.

REASONS FOR CHANGE

The Committee is concerned that partnership technical terminations are being used electively to change partnership-level elections and attributes in a way which otherwise would not be permitted. Following these elective terminations, the partnership remains in existence and can continue to do business, but with refreshed tax attributes. Because of the perceived abuse of the technical termination rule, the Committee believes its repeal will improve tax administration and increase taxpayer compliance.

EXPLANATION OF PROVISION

The provision repeals the section 708(b)(1)(B) rule providing for technical terminations of partnerships. The provision does not change the present-law rule of section 708(b)(1)(A) that a partnership is considered as terminated if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership.

EFFECTIVE DATE

The provision applies to partnership taxable years beginning after December 31, 2017.

[561] Sec. 708(b)(1)(A).
[562] Sec. 708(b)(1)(B).
[563] Treas. Reg. sec. 1.708–1(b)(4).
[564] Sec. 706(c)(1); Treas. Reg. sec. 1.708–1(b)(3).
[565] Partnership level elections include, for example, the section 754 election to adjust basis on a transfer or distribution, as well as other elections that determine the partnership's tax treatment of partnership items. A list of elections can be found at William S. McKee, William F. Nelson, and Robert L. Whitmire, *Federal Taxation of Partnerships and Partners*, 4th edition, para. 9.01[7], pp. 9–42—9–44.

14. Recharacterization of certain gains in the case of partnership profits interests held in connection with performance of investment services (sec. 3314 of the bill and secs. 1 and 83 of the Code)

PRESENT LAW

Partnership profits interest for services

A profits interest in a partnership is the right to receive future profits in the partnership but does not generally include any right to receive money or other property upon the immediate liquidation of the partnership. The treatment of the receipt of a profits interest in a partnership (sometimes referred to as a carried interest) in exchange for the performance of services has been the subject of controversy. Though courts have differed, in some instances, a taxpayer receiving a profits interest for performing services has not been taxed upon the receipt of the partnership interest.[566]

In 1993, the Internal Revenue Service, referring to the litigation of the tax treatment of receiving a partnership profits interest and the results in the cases, issued administrative guidance that the IRS generally would treat the receipt of a partnership profits interest for services as not a taxable event for the partnership or the partner.[567] Under this guidance, this treatment does not apply, however, if: (1) the profits interest relates to a substantially certain and predictable stream of income from partnership assets, such as income from high-quality debt securities or a high-quality net lease; (2) within two years of receipt, the partner disposes of the profits interest; or (3) the profits interest is a limited partnership interest in a publicly traded partnership. More recent administrative guidance[568] clarifies that this treatment applies with respect to substantially unvested profits interests provided the service partner takes into income his distributive share of partnership income, and the partnership does not deduct any amount either on grant or on vesting of the profits interest.[569]

By contrast, a partnership capital interest received for services is includable in the partner's income under generally applicable rules relating to the receipt of property for the performance of services.[570] A partnership capital interest for this purpose is an interest that would entitle the receiving partner to a share of the proceeds if the partnership's assets were sold at fair market value and the proceeds were distributed in liquidation.[571]

[566] Only a handful of cases have addressed this issue. Though one case required the value to be included currently, where value was easily determined by a sale of the profits interest soon after receipt (*Diamond v. Commissioner*, 56 T.C. 530 (1971), aff'd 492 F.2d 286 (7th Cir. 1974)), a more recent case concluded that partnership profits interests were not includable on receipt, because the profits interests were speculative and without fair market value (*Campbell v. Commissioner*, 943 F. 2d 815 (8th Cir. 1991)).

[567] Rev. Proc. 93–27 (1993–2 C.B. 343), citing the *Diamond* and *Campbell* cases, *supra*.

[568] Rev. Proc. 2001–43 (2001–2 C.B. 191). This result applies under the guidance even if the interest is substantially nonvested on the date of grant.

[569] A similar result would occur under the "safe harbor" election under proposed regulations regarding the application of section 83 to the compensatory transfer of a partnership interest. REG–105346–03, 70 Fed. Reg. 29675 (May 24, 2005).

[570] Secs. 61 and 83; Treas. Reg. sec. 1.721–1(b)(1); see *U.S.* v. *Frazell*, 335 F.2d 487 (5th Cir. 1964), cert. denied, 380 U.S. 961 (1965).

[571] Rev. Proc. 93–27, 1993–2 C.B. 343.

Property received for services under section 83

In general

Section 83 governs the amount and timing of income and deductions attributable to transfers of property in connection with the performance of services. If property is transferred in connection with the performance of services, the person performing the services (the "service provider") generally must recognize income for the taxable year in which the property is first substantially vested (i.e., transferable or not subject to a substantial risk of forfeiture).[572] The amount includible in the service provider's income is the excess of the fair market value of the property over the amount (if any) paid for the property. A deduction is allowed to the person for whom such services are performed (the "service recipient") equal to the amount included in gross income by the service provider.[573] The deduction is allowed for the taxable year of the service recipient in which or with which ends the taxable year in which the amount is included in the service provider's income.

Property that is subject to a substantial risk of forfeiture and that is not transferable is generally referred to as "substantially nonvested." Property is subject to a substantial risk of forfeiture if the individual's right to the property is conditioned on the future performance (or refraining from performance) of substantial services. In addition, a substantial risk of forfeiture exists if the right to the property is subject to a condition other than the performance of services, provided that the condition relates to a purpose of the transfer and there is a substantial possibility that the property will be forfeited if the condition does not occur.

Section 83(b) election

Under section 83(b), even if the property is substantially nonvested at the time of transfer, the service provider may nevertheless elect within 30 days of the transfer to recognize income for the taxable year of the transfer. Such an election is referred to as a "section 83(b) election." The service provider makes an election by filing with the IRS a written statement that includes the fair market value of the property at the time of transfer and the amount (if any) paid for the property. The service provider must also provide a copy of the statement to the service recipient.

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[572] The Department of Treasury has issued proposed regulations regarding the application of section 83 to the compensatory transfer of a partnership interest. 70 Fed. Reg. 29675 (May 24, 2005). The proposed regulations provide that a partnership interest is "property" for purposes of section 83. Thus, a compensatory transfer of a partnership interest is includible in the service provider's gross income at the time that it first becomes substantially vested (or, in the case of a substantially nonvested partnership interest, at the time of grant if a section 83(b) election is made). However, because the fair market value of a compensatory partnership interest is often difficult to determine, the proposed regulations also permit a partnership and a partner to elect a safe harbor under which the fair market value of a compensatory partnership interest is treated as being equal to the liquidation value of that interest. Therefore, in the case of a true profits interest in a partnership (one under which the partner would be entitled to nothing if the partnership were liquidated immediately following the grant), under the proposed regulations, the grant of a substantially vested profits interest (or, if a section 83(b) election is made, the grant of a substantially nonvested profits interest) results in no income inclusion under section 83 because the fair market value of the property received by the service provider is zero. The proposed safe harbor is subject to a number of conditions. For example, the election cannot be made retroactively and must apply to all compensatory partnership transfers that occur during the period that the election is in effect.

[573] Sec. 83(h).

Passthrough tax treatment of partnerships

The character of partnership items passes through to the partners, as if the items were realized directly by the partners.[574] Thus, for example, long-term capital gain of the partnership is treated as long-term capital gain in the hands of the partners.

A partner holding a partnership interest includes in income its distributive share (whether or not actually distributed) of partnership items of income and gain, including capital gain eligible for the lower tax rates. A partner's basis in the partnership interest is increased by any amount of gain thus included and is decreased by losses. These basis adjustments prevent double taxation of partnership income to the partner, preserving the partnership's tax status as a passthrough entity. Money distributed to the partner by the partnership is taxed to the extent the amount exceeds the partner's basis in the partnership interest.

Net long-term capital gain

In the case of an individual, estate, or trust, any adjusted net capital gain which otherwise would be taxed at the 10- or 15-percent rate is not taxed. Any adjusted net capital gain which otherwise would be taxed at rates over 15 percent and below 39.6 percent is taxed at a 15-percent rate. Any adjusted net capital gain which otherwise would be taxed at a 39.6-percent rate is taxed at a 20-percent rate.[575]

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset,[576] any gain generally is included in income.

Short-term capital gain means gain from the sale or exchange of a capital asset held for not more than one year, if and to the extent such gain is taken into account in computing gross income. Net short-term capital loss means the excess of short term capital losses for the taxable year over the short-term capital gains for the taxable year.

Net long-term capital gain means the excess of long-term capital gains for the taxable year over the long-term capital losses for the taxable year.

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[574] Sec. 702.

[575] Sec. 1. Other rates apply to certain types of gain. The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 10- or 15-percent rate is taxed at the otherwise applicable rate. In addition, a tax is imposed on net investment income in the case of an individual, estate, or trust. In the case of an individual, the tax is 3.8 percent of the lesser of net investment income, which includes gains and dividends, or the excess of modified adjusted gross income over the threshold amount. The threshold amount is $250,000 in the case of a joint return or surviving spouse, $125,000 in the case of a married individual filing a separate return, and $200,000 in the case of any other individual.

[576] Sec. 1221. A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances available under the straight-line method of depreciation.

Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

The adjusted net capital gain of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain that the individual treats as investment income for purposes of determining the investment interest limitation.[577]

REASONS FOR CHANGE

The Committee is concerned about Federal tax issues arising from the use of carried interests in asset management businesses. In these arrangements, the investment fund typically is a partnership. The investors are limited partners that contribute capital to acquire fund assets, and the fund manager is the general partner of the investment fund partnership. The general partner is itself a partnership of individuals with investment management expertise. The fund manager receives management fees along with a carried interest. The arrangement requires the performance of services by individuals whose professional skill as fund managers generates capital income for investors in the fund.

Because the character of a partnership's income passes through to partners, income from a carried interest may take the form of long-term or short-term capital gain realized by the underlying investment fund as the fund sells off investment assets. Long-term capital gain allocated to individual partners may represent compensation for their services as fund managers.

The Committee believes that the lower rates that apply to long-term capital gain from sales or exchanges of capital assets of partnerships should not be available to holders of applicable partnership interests unless an extended holding period requirement has been met. Therefore, the Committee bill imposes a three-year holding period (not the generally applicable one-year holding period) in the case of long-term capital gain from applicable partnership interests. If the holder of an applicable partnership interest is allocated gain from the sale of property held for less than three years, that gain is treated as short-term capital gain and is subject to tax at the rates applicable to ordinary income. The Committee believes that providing a three-year holding period requirement on certain capital gains for holders of applicable partnership interests strikes the right balance for economic growth and fairness without stifling investment.

EXPLANATION OF PROVISION

General rule

The provision provides for a three-year holding period in the case of certain net long-term capital gain with respect to any applicable partnership interest held by the taxpayer.

[577] Sec. 163(d).

Section 83 (relating to property transferred in connection with performance of services) does not apply to the transfer of a partnership interest to which the provision applies.

Short-term capital gain

The provision treats as short-term capital gain taxed at ordinary income rates the amount of the taxpayer's net long-term capital gain with respect to an applicable partnership interest for the taxable year that exceeds the amount of such gain calculated as if a three-year (not one-year) holding period applies. In making this calculation, the provision takes account of long-term capital losses calculated as if a three-year holding period applies.

A special rule provides that, as provided in regulations or other guidance issued by the Secretary, this rule does not apply to income or gain attributable to any asset that is not held for portfolio investment on behalf of third party investors. Third party investor means a person (1) who holds an interest in the partnership that is not property held in connection with an applicable trade or business (defined below) with respect to that person, and (2) who is not and has not been actively engaged in directly or indirectly providing substantial services for the partnership or any applicable trade or business (and is (or was) not related to a person so engaged). A related person for this purpose is a family member (within the meaning of attribution rules [578]) or colleague, that is a person who performed a service within the current calendar year or the preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.

Applicable partnership interest

An applicable partnership interest is any interest in a partnership that, directly or indirectly, is transferred to (or held by) the taxpayer in connection with performance of services in any applicable trade or business. The services may be performed by the taxpayer or by any other related person or persons in any applicable trade or business. It is intended that partnership interests shall not fail to be treated as transferred or held in connection with the performance of services merely because the taxpayer also made contributions to the partnership, and the Treasury Department is directed to provide guidance implementing this intent. An applicable partnership interest does not include an interest held by a person who is employed by another entity that is conducting a trade or business (which is not an applicable trade or business) and who provides services only to the other entity.

An applicable partnership interest does not include an interest in a partnership directly or indirectly held by a corporation. For example, if two corporations form a partnership to conduct a joint venture for developing and marketing a pharmaceutical product, the partnership interests held by the two corporations are not applicable partnership interests.

An applicable partnership interest does not include any capital interest in a partnership giving the taxpayer a right to share in partnership capital commensurate with the amount of capital contributed (as of the time the partnership interest was received), or

[578] Sec. 318(a)(1).

commensurate with the value of the partnership interest that is taxed under section 83 on receipt or vesting of the partnership interest. For example, in the case of a partner who holds a capital interest in the partnership with respect to capital he or she contributed to the partnership, if the partnership agreement provides that the partner's share of partnership capital is commensurate with the amount of capital he or she contributed (as of the time the partnership interest was received) compared to total partnership capital, the partnership interest is not an applicable partnership interest to that extent.

Applicable trade or business

An applicable trade or business means any activity (regardless of whether the activity are conducted in one or more entities) that consists in whole or in part of the following: (1) raising or returning capital, and either (2) investing in (or disposing of) specified assets (or identifying specified assets for investing or disposition), or (3) developing specified assets.

Developing specified assets takes place, for example, if it is represented to investors, lenders, regulators, or others that the value, price, or yield of a portfolio business may be enhanced or increased in connection with choices or actions of a service provider or of others acting in concert with or at the direction of a service provider. Services performed as an employee of an applicable trade or business are treated as performed in an applicable trade or business for purposes of this rule. Merely voting shares owned does not amount to development; for example, a mutual fund that merely votes proxies received with respect to shares of stock it holds is not engaged in development.

Specified assets

Under the provision, specified assets means securities (generally as defined under rules for mark-to-market accounting for securities dealers), commodities (as defined under rules for mark-to-market accounting for commodities dealers), real estate held for rental or investment, cash or cash equivalents, options or derivative contracts with respect to such securities, commodities, real estate, cash or cash equivalents, as well as an interest in a partnership to the extent of the partnership's proportionate interest in the foregoing. A security for this purpose means any (1) share of corporate stock, (2) partnership interest or beneficial ownership interest in a widely held or publicly traded partnership or trust, (3) note, bond, debenture, or other evidence of indebtedness, (4) interest rate, currency, or equity notional principal contract, (5) interest in, or derivative financial instrument in, any such security or any currency (regardless of whether section 1256 applies to the contract), and (6) position that is not such a security and is a hedge with respect to such a security and is clearly identified. A commodity for this purpose means any (1) commodity that is actively traded, (2) notional principal contract with respect to such a commodity, (3) interest in, or derivative financial instrument in, such a commodity or notional principal contract, or (4) position that is not such a commodity and is a hedge with respect to such a commodity and is clearly identified. For purposes of the provision, real estate held for rental or investment does not include, for example, real estate on which the holder operates an active farm.

A partnership interest, for purposes of determining the proportionate interest of a partnership in any specified asset, includes any partnership interest that is not otherwise treated as a security for purposes of the provision (for example, an interest in a partnership that is not widely held or publicly traded). For example, assume that a hedge fund acquires an interest in an operating business conducted in the form of a non-publicly traded partnership that is not widely held; the partnership interest is a specified asset for purposes of the provision.

Transfer of applicable partnership interest to related person

If a taxpayer transfers any applicable partnership interest, directly or indirectly, to a person related to the taxpayer, then the taxpayer includes in gross income as short-term capital gain so much of the taxpayer's net long-term capital gain attributable to the sale or exchange of an asset held for not more than three years as is allocable to the interest. The amount included as short-term capital gain on the transfer is reduced by the amount treated as short-term capital gain on the transfer for the taxable year under the general rule of the provision (that is, amounts are not double-counted). A related person for this purpose is a family member (within the meaning of attribution rules)[579] or colleague, that is a person who performed a service within the current calendar year or the preceding three calendar years in any applicable trade or business in which or for which the taxpayer performed a service.

Reporting requirement

The Secretary is directed to require reporting (at the time in the manner determined by the Secretary) necessary to carry out the purposes of the provision. The penalties otherwise applicable to a failure to report to partners under section 6031(b) apply to failure to report under this requirement.

Regulatory authority

The Treasury Department is directed to issue regulations or other guidance necessary to carry out the provision. Such guidance is to address prevention of the abuse of the purposes of the provision, including through the allocation of income to tax-indifferent parties. Guidance is also to provide for the application of the provision in the case of tiered structures of entities.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

15. Amortization of research and experimental expenditures (sec. 3315 of the bill and sec. 174 of the Code)

PRESENT LAW

Business expenses associated with the development or creation of an asset having a useful life extending beyond the current year

[579] Sec. 318(a)(1).

generally must be capitalized and depreciated over such useful life.[580] Taxpayers, however, may elect to deduct currently the amount of certain reasonable research or experimentation expenditures paid or incurred in connection with a trade or business.[581] Taxpayers may choose to forgo a current deduction, capitalize their research expenditures, and recover them ratably over the useful life of the research, but in no case over a period of less than 60 months.[582] Taxpayers, alternatively, may elect to amortize their research expenditures over a period of 10 years.[583] Research and experimental expenditures deductible under section 174 are not subject to capitalization under either section 263(a)[584] or section 263A.[585]

Amounts defined as research or experimental expenditures under section 174 generally include all costs incurred in the experimental or laboratory sense related to the development or improvement of a product.[586] In particular, qualifying costs are those incurred for activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product.[587] Uncertainty exists when information available to the taxpayer is not sufficient to ascertain the capability or method for developing, improving, and/or appropriately designing the product.[588] The determination of whether expenditures qualify as deductible research expenses depends on the nature of the activity to which the costs relate, not the nature of the product or improvement being developed or the level of technological advancement the product or improvement represents. Examples of qualifying costs include salaries for those engaged in research or experimentation efforts, amounts incurred to operate and maintain research facilities (*e.g.*, utilities, depreciation, rent), and expenditures for materials and supplies used and consumed in the course of research or experimentation (including amounts incurred in conducting trials).[589] In addition, under administrative guidance, the costs of developing

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[580] Secs. 167 and 263(a).

[581] Secs. 174(a) and (e).

[582] Sec. 174(b). Taxpayers generating significant short-term losses often choose to defer the deduction for their research and experimentation expenditures under this section. Additionally, section 174 amounts are excluded from the definition of "start-up expenditures" under section 195 (section 195 generally provides that start-up expenditures in excess of $5,000 either are not deductible or are amortizable over a period of not less than 180 months once an active trade or business begins). So as not to generate significant losses before beginning their trade or business, a taxpayer may choose to defer the deduction and amortize its section 174 costs beginning with the month in which the taxpayer first realizes benefits from the expenditures.

[583] Secs. 174(f)(2) and 59(e). This special 10-year election is available to mitigate the effect of the alternative minimum tax adjustment for research expenditures set forth in section 56(b)(2). Taxpayers with significant losses also may elect to amortize their otherwise deductible research and experimentation expenditures to reduce amounts that could be subject to expiration under the net operating loss carryforward regime.

[584] Sec. 263(a)(1)(B).

[585] Sec. 263A(c)(2).

[586] Treas. Reg. sec. 1.174–2(a)(1) and (2). Product is defined to include any pilot model, process, formula, invention, technique, patent, or similar property, and includes products to be used by the taxpayer in its trade or business as well as products to be held for sale, lease, or license. Treas. Reg. sec. 1.174–2(a)(11), Example 10, provides an example of new process development costs eligible for section 174 treatment.

[587] Treas. Reg. sec. 1.174–2(a)(1).

[588] *Ibid*.

[589] See Treas. Reg. sec. 1.174–4(c). The definition of research and experimental expenditures also includes the costs of obtaining a patent, such as attorneys' fees incurred in making and perfecting a patent. Treas. Reg. sec. 1.174–2(a)(1).

computer software have been accorded treatment similar to research expenditures.[590]

Research or experimental expenditures under section 174 do not include expenditures for quality control testing; efficiency surveys; management studies; consumer surveys; advertising or promotions; the acquisition of another's patent, model, production or process; or research in connection with literary, historical, or similar projects.[591] For purposes of section 174, quality control testing means testing to determine whether particular units of materials or products conform to specified parameters, but does not include testing to determine if the design of the product is appropriate.[592]

Generally, no current deduction under section 174 is allowable for expenditures for the acquisition or improvement of land or of depreciable or depletable property used in connection with any research or experimentation.[593] In addition, no current deduction is allowed for research expenses incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral, including oil and gas.[594]

REASONS FOR CHANGE

The Committee recognizes that research and experimentation expenditures have a useful life beyond the tax year in which the expenditures are incurred, and that the tangible and intangible property created through research and experimentation activities provide value to a business beyond a single tax year. The Committee also acknowledges that the costs of developing software closely resemble the types of research and experimental expenditures that fall within the purview of section 174, and therefore should be accorded similar treatment. For these reasons, the Committee believes research expenses, including software development costs, should be amortized over a period beyond the current year. Further, the Committee believes that research and experimentation expenditures that are attributable to research conducted outside of the United States should be amortized over a longer period so as to encourage research and experimental activities inside the United States.

EXPLANATION OF PROVISION

Under the provision, amounts defined as specified research or experimental expenditures are required to be capitalized and amortized ratably over a five-year period, beginning with the midpoint of the taxable year in which the specified research or experimental expenditures were paid or incurred. Specified research or experimental expenditures which are attributable to research that is conducted outside of the United States[595] are required to be capitalized and amortized ratably over a period of 15 years, beginning with the midpoint of the taxable year in which such expenditures

[590] Rev. Proc. 2000–50, 2000–2 C.B. 601.
[591] Treas. Reg. sec. 1.174–2(a)(6).
[592] Treas. Reg. sec. 1.174–2(a)(7).
[593] Sec. 174(c).
[594] Sec. 174(d). Special rules apply with respect to geological and geophysical costs (section 167(h)), qualified tertiary injectant expenses (section 193), intangible drilling costs (sections 263(c) and 291(b)), and mining exploration and development costs (sections 616 and 617).
[595] For this purpose, the term "United States" includes the United States, the Commonwealth of Puerto Rico, and any possession of the United States.

were paid or incurred. Specified research or experimental expenditures subject to capitalization include expenditures for software development.

Specified research or experimental expenditures do not include expenditures for land or for depreciable or depletable property used in connection with the research or experimentation, but do include the depreciation and depletion allowances of such property. Also excluded are exploration expenditures incurred for ore or other minerals (including oil and gas).

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

As part of the repeal of the alternative minimum tax, taxpayers may no longer elect to amortize their research or experimental expenditures over a period of 10 years.[596]

It is the intent of the Committee that application of this rule shall be treated as a change in the taxpayer's method of accounting for purposes of section 481, initiated by the taxpayer, and made with the consent of the Secretary. It is the intent of the Committee that this rule be applied on a cutoff basis to research and experimental expenditures paid or incurred in taxable years beginning after December 31, 2022 (hence there is no adjustment under section 481(a) for research and experimental expenditures paid or incurred in taxable years beginning before January 1, 2023).

EFFECTIVE DATE

The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2022.

16. Uniform treatment of expenses in contingency fee cases (sec. 3316 of the bill and new sec. 162(q) of the Code)

PRESENT LAW

The Code provides that a taxpayer may deduct all ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business.[597]

A current deduction for an expense for which there is a right or expectation of reimbursement may be disallowed because these payments are not expenses of the taxpayer and are instead in the nature of an advance or a loan. The extent to which the right must be established has varied. Some cases have denied the current deduction because the right of reimbursement was fixed,[598] others have allowed the current deduction because the right of reimbursement was uncertain,[599] and other cases have denied the current de-

[596] See section 2001 of the bill (Repeal of alternative minimum tax).

[597] Sec. 162(a); Treas. Reg. sec. 1.162–1(a).

[598] *Charles Baloian Company, Inc.* v. *Commissioner,* 68 T.C. 620, 626, 628 (1977); *Manocchio* v. *Commissioner,* 710 F.2d 1400, 1402 (9th Cir. 1983); *Glendinning, McLeish & Co.* v. *Commissioner,* 61 F.2d 950, 952 (2d Cir. 1932); *Webbe* v. *Commissioner,* T.C. Memo. 1987–426, aff'd, 902 F.2d 688 (8th Cir. 1990).

[599] *George K. Herman Chevrolet, Inc.* v. *Commissioner,* 39 T.C. 846, 853 (1963); *Allegheny Corporation* v. *Commissioner,* 28 T.C. 298, 305 (1957), acq., 1957–2 C.B. 3; *Electric Tachometer Corporation* v. *Commissioner,* 37 T.C. 158, 161–162 (1961), acq., 1962–2 C.B. 4.

duction if the taxpayer's right to reimbursement was subject to a contingency.

Courts have held that an attorney representing clients on a contingent fee basis may not currently deduct advances to or expenses paid on behalf of the clients as ordinary and necessary business expenses.[600] The amounts in these cases were to be repaid from any recovery. Courts have also held that even if reimbursement is due only under certain circumstances, generally no immediate deduction is allowable.[601]

However, the Ninth Circuit reached the opposite conclusion and held that attorneys who represent clients in "gross fee" contingency fee cases are not extending loans to clients and therefore may treat litigation costs, such as court fees and witness expenses, as deductible business expenses under the Code.[602] The IRS does not follow this decision, except in the Ninth Circuit, based on the fact that amounts advanced by attorneys will be reimbursed by the client and therefore are not deductible business expenses.[603]

REASONS FOR CHANGE

The Committee believes that amounts advanced by attorneys in "gross fee" cases are loans and therefore should not be treated as deductible expenses. The Committee further believes this change is necessary to provide uniform treatment of expenses in contingency fee cases.

EXPLANATION OF PROVISION

The provision denies attorneys an otherwise-allowable deduction for litigation costs paid under arrangements that are primarily on a contingent fee basis until the contingency ends.

The provision effects a legislative override of the opinion in the Ninth Circuit Court of Appeals in *Boccardo* v. *Commissioner*, 56 F.3d 1016 (9th Cir. 1995). No inference regarding the tax treatment of these costs under present law is intended.

EFFECTIVE DATE

The provision applies to expenses and costs paid or incurred in taxable years beginning after the date of enactment.

E. Reform of Business Credits

1. Repeal of credit for clinical testing expenses for certain drugs for rare diseases or conditions (sec. 3401 of the bill and sec. 45C of the Code)

PRESENT LAW

Section 45C provides a 50-percent business tax credit for qualified clinical testing expenses incurred in testing of certain drugs for

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[600] *Burnett* v. *Commissioner,* 356 F.2d 755, 760 (5th Cir.), cert. denied, 385 U.S. 832 (1966); *Herrick* v. *Commissioner,* 63 T.C. 562, 567, 568 (1975); *Canelo* v. *Commissioner,* 53 T.C. 217, 225 (1969), aff'd, 447 F.2d 484 (9th Cir. 1971), acq. 1971–2 C.B. 2, nonacq. in part, 1982–2 C.B. 2; *Silverton* v. *Commissioner,* T.C. Memo. 1977–198, aff'd, 647 F.2d 172 (9th Cir.), cert. denied, 454 U.S. 1033 (1981); *Watts* v. *Commissioner*, T.C. Memo. 1968–183.

[601] *Boccardo* v. *Commissioner,* 12 Cl Ct. 184 (1987); *Boccardo* v. *Commissioner,* 65 T.C.M. 2739 (1993).

[602] *Boccardo v. Commissioner,* 56 F.3d 1016 (9th Cir. 1995), rev'g 65 T.C.M. 2739 (1993).

[603] 1997 FSA LEXIS 442 (June 2, 1997).

rare diseases or conditions, generally referred to as "orphan drugs." Qualified clinical testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration ("FDA") but before the drug has been approved for sale by the FDA.[604] A rare disease or condition is defined as one that (1) affects fewer than 200,000 persons in the United States, or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for such disease or condition from sales in the United States of the drug.[605]

Amounts included in computing the credit under this section are excluded from the computation of the research credit under section 41.[606]

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the orphan drug credit, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the credit for qualified clinical testing expenses.

EFFECTIVE DATE

The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2017. 604 Sec. 45C(b). 605 Sec. 45C(d). 606 Sec. 45C(c).

2. Repeal of employer-provided child care credit (sec. 3402 of the bill and sec. 45F of the Code)

PRESENT LAW

Taxpayers are eligible for a tax credit equal to 25 percent of qualified expenditures for employee child care and 10 percent of qualified expenditures for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer may not exceed $150,000 per taxable year. The credit is part of the general business credit.[607]

Qualified child care expenditures generally include costs paid or incurred: (1) to acquire, construct, rehabilitate, or expand property that is to be used as part of the taxpayer's qualified child care facility;[608] (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide

[604] Sec. 45C(b).
[605] Sec. 45C(d).
[606] Sec. 45C(c).
[607] Sec. 38(b)(15).
[608] In addition, a depreciation deduction (or amortization in lieu of depreciation) must be allowable with respect to the property and the property must not be part of the principal residence of the taxpayer or any employee of the taxpayer.

child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws.

Qualified child care expenditures for resource and referral services include amounts paid under contract to provide child care resource and referral services to a taxpayer's employees.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the employer-provided child care credit, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the credit for qualified child care expenditures and qualified child care expenditures for resource and referral services.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

3. Repeal of rehabilitation credit (sec. 3403 of the bill and sec. 47 of the Code)

PRESENT LAW

Section 47 provides a two-tier tax credit for rehabilitation expenditures.

A 20-percent credit is provided for qualified rehabilitation expenditures with respect to a certified historic structure. For this purpose, a certified historic structure means any building that is listed in the National Register, or that is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary of the Treasury as being of historic significance to the district.

A 10-percent credit is provided for qualified rehabilitation expenditures with respect to a qualified rehabilitated building, which generally means a building that was first placed in service before 1936. A pre-1936 building must meet requirements with respect to retention of existing external walls and internal structural framework of the building in order for expenditures with respect to it to qualify for the 10-percent credit. A building is treated as having met the substantial rehabilitation requirement under the 10-percent credit only if the rehabilitation expenditures during the 24-month period selected by the taxpayer and ending within the taxable year exceed the greater of (1) the adjusted basis of the building (and its structural components), or (2) $5,000.

The provision requires the use of straight-line depreciation or the alternative depreciation system in order for rehabilitation expenditures to be treated as qualified under the provision.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the rehabilitation credit, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the rehabilitation credit.

EFFECTIVE DATE

The provision applies to amounts paid or incurred after December 31, 2017. A transition rule provides that in the case of qualified rehabilitation expenditures (within the meaning of present law), with respect to any building owned or leased by the taxpayer at all times on and after January 1, 2018, the 24-month period selected by the taxpayer (under section 47(c)(1)(C)) is to begin not later than the end of the 180-day period beginning on the date of the enactment of the Act, and the amendments made by the provision apply to such expenditures paid or incurred after the end of the taxable year in which such 24-month period ends.

4. Repeal of work opportunity tax credit (sec. 3404 of the bill and sec. 51 of the Code)

PRESENT LAW

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of ten targeted groups. The amount of the credit available to an employer is determined by the amount of qualified wages paid by the employer. Generally, qualified wages consist of wages attributable to services rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer (two years in the case of an individual in the long-term family assistance recipient category).

Targeted groups eligible for the credit

Generally, an employer is eligible for the credit only for qualified wages paid to members of a targeted group. These targeted groups are: (1) Families receiving TANF; (2) Qualified veterans; (3) Qualified ex-felons; (4) Designated community residents; (5) Vocational rehabilitation referrals; (6) Qualified summer youth employees; (7) Qualified food and nutrition recipients; (8) Qualified SSI recipients; (9) Long-term family assistance recipients; and (10) Qualified long-term unemployment recipients.

Qualified wages

Generally, qualified wages are defined as cash wages paid by the employer to a member of a targeted group. The employer's deduction for wages is reduced by the amount of the credit.

For purposes of the credit, generally, wages are defined by reference to the FUTA definition of wages contained in section 3306(b) (without regard to the dollar limitation therein contained). Special rules apply in the case of certain agricultural labor and certain railroad labor.

Calculation of the credit

The credit available to an employer for qualified wages paid to members of all targeted groups (except for long-term family assistance recipients and qualified veterans) equals 40 percent (25 percent for employment of 400 hours or less) of qualified first-year wages. Generally, qualified first-year wages are qualified wages (not in excess of $6,000) attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages). Except for long-term family assistance recipients, no credit is allowed for second-year wages.

In the case of long-term family assistance recipients, the credit equals 40 percent (25 percent for employment of 400 hours or less) of $10,000 for qualified first-year wages and 50 percent of the first $10,000 of qualified second-year wages. Generally, qualified second-year wages are qualified wages (not in excess of $10,000) attributable to service rendered by a member of the long-term family assistance category during the one-year period beginning on the day after the one-year period beginning with the day the individual began work for the employer. Therefore, the maximum credit per employee is $9,000 (40 percent of the first $10,000 of qualified first-year wages plus 50 percent of the first $10,000 of qualified second-year wages).

In the case of a qualified veterans, the credit is calculated as follows: (1) in the case of a qualified veteran who was eligible to receive assistance under a supplemental nutritional assistance program (for at least a three-month period during the year prior to the hiring date) the employer is entitled to a maximum credit of 40 percent of $6,000 of qualified first-year wages; (2) in the case of a qualified veteran who is entitled to compensation for a service connected disability, who is hired within one year of discharge, the employer is entitled to a maximum credit of 40 percent of $12,000 of qualified first-year wages; (3) in the case of a qualified veteran who is entitled to compensation for a service connected disability, and who has been unemployed for an aggregate of at least six months during the one-year period ending on the hiring date, the employer is entitled to a maximum credit of 40 percent of $24,000 of qualified first-year wages; (4) in the case of a qualified veteran unemployed for at least four weeks but less than six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $6,000 of qualified first-year wages; and (5) in the case of a qualified veteran unemployed for at least six months (whether or not consecutive) during the one-year period ending on the date of hiring, the maximum credit equals 40 percent of $14,000 of qualified first-year wages.

Expiration

The work opportunity tax credit is not available with respect to wages paid to individuals who begin work for an employer after December 31, 2019.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the work opportunity tax credit, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is a necessary part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the work opportunity tax credit.

EFFECTIVE DATE

The provision applies to amounts paid or incurred to individuals who begin work for the employer after December 31, 2017.

5. Repeal of deduction for certain unused business credits (sec. 3405 of the bill and sec. 196 of the Code)

PRESENT LAW

The general business credit ("GBC") consists of various individual tax credits allowed with respect to certain qualified expenditures and activities.[609] In general, the various individual tax credits contain provisions that prohibit "double benefits," either by denying deductions in the case of expenditure-related credits or by requiring income inclusions in the case of activity-related credits. Unused credits may be carried back one year and carried forward 20 years.[610]

Section 196 allows a deduction to the extent that certain portions of the GBC expire unused after the end of the carry forward period. In general, 100 percent of the unused credit is allowed as a deduction in the taxable year after such credit expired. However, with respect to the investment credit determined under section 46 (other than the rehabilitation credit) and the research credit determined under section 41(a) (for a taxable year beginning before January 1, 1990), section 196 limits the deduction to 50 percent of such unused credits.[611]

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the deduction for certain unused business credits, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is a necessary part of its larger tax reform effort.

[609] Sec. 38.
[610] Sec. 39.
[611] Sec. 196(d).

EXPLANATION OF PROVISION

This provision repeals the deduction for certain unused business credits.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

6. Termination of new markets tax credit (sec. 3406 of the bill and sec. 45D of the Code)

PRESENT LAW

Section 45D provides a new markets tax credit for qualified equity investments made to acquire stock in a corporation, or a capital interest in a partnership, that is a qualified community development entity ("CDE").[612] The amount of the credit allowable to the investor (either the original purchaser or a subsequent holder) is (1) a five-percent credit for the year in which the equity interest is purchased from the CDE and for each of the following two years, and (2) a six-percent credit for each of the following four years.[613] The credit is determined by applying the applicable percentage (five or six percent) to the amount paid to the CDE for the investment at its original issue, and is available to the taxpayer who holds the qualified equity investment on the date of the initial investment or on the respective anniversary date that occurs during the taxable year.[614] The credit is recaptured if at any time during the seven-year period that begins on the date of the original issue of the investment the entity (1) ceases to be a qualified CDE, (2) the proceeds of the investment cease to be used as required, or (3) the equity investment is redeemed.[615]

A qualified CDE is any domestic corporation or partnership: (1) whose primary mission is serving or providing investment capital for low-income communities or low-income persons; (2) that maintains accountability to residents of low-income communities by their representation on any governing board of or any advisory board to the CDE; and (3) that is certified by the Secretary as being a qualified CDE.[616] A qualified equity investment means stock (other than nonqualified preferred stock) in a corporation or a capital interest in a partnership that is acquired at its original issue directly (or through an underwriter) from a CDE for cash, and includes an investment of a subsequent purchaser if such investment was a qualified equity investment in the hands of the prior holder.[617] Substantially all of the investment proceeds must be used by the CDE to make qualified low-income community investments and the investment must be designated as a qualified equity investment by the CDE. For this purpose, qualified low-income community investments include: (1) capital or equity investments in, or loans to, qualified active low-income community busi-

[612] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554.
[613] Sec. 45D(a)(2).
[614] Sec. 45D(a)(3).
[615] Sec. 45D(g).
[616] Sec. 45D(c).
[617] Sec. 45D(b).

nesses; (2) certain financial counseling and other services to businesses and residents in low-income communities; (3) the purchase from another CDE of any loan made by such entity that is a qualified low-income community investment; or (4) an equity investment in, or loan to, another CDE.[618]

A "low-income community" is a population census tract with either (1) a poverty rate of at least 20 percent or (2) median family income which does not exceed 80 percent of the greater of metropolitan area median family income or statewide median family income (for a non-metropolitan census tract, does not exceed 80 percent of statewide median family income). In the case of a population census tract located within a high migration rural county, low-income is defined by reference to 85 percent (as opposed to 80 percent) of statewide median family income.[619] For this purpose, a high migration rural county is any county that, during the 20-year period ending with the year in which the most recent census was conducted, has a net out-migration of inhabitants from the county of at least 10 percent of the population of the county at the beginning of such period.

The Secretary is authorized to designate "targeted populations" as low-income communities for purposes of the new markets tax credit.[620] For this purpose, a "targeted population" is defined by reference to section 103(20) of the Riegle Community Development and Regulatory Improvement Act of 1994[621] (the "Act") to mean individuals, or an identifiable group of individuals, including an Indian tribe, who are low-income persons or otherwise lack adequate access to loans or equity investments. Section 103(17) of the Act provides that "low income" means (1) for a targeted population within a metropolitan area, less than 80 percent of the area median family income; and (2) for a targeted population within a non-metropolitan area, less than the greater of 80 percent of the area median family income or 80 percent of the statewide non-metropolitan area median family income. A targeted population is not required to be within any census tract. In addition, a population census tract with a population of less than 2,000 is treated as a low-income community for purposes of the credit if such tract is within an empowerment zone, the designation of which is in effect under section 1391, and is contiguous to one or more low-income communities.

A qualified active low-income community business is defined as a business that satisfies, with respect to a taxable year, the following requirements: (1) at least 50 percent of the total gross income of the business is derived from the active conduct of trade or business activities in any low-income community; (2) a substantial portion of the tangible property of the business is used in a low-income community; (3) a substantial portion of the services performed for the business by its employees is performed in a low-income community; and (4) less than five percent of the average of the aggregate unadjusted bases of the property of the business is

[618] Sec. 45D(d).
[619] Sec. 45D(e).
[620] Sec. 45D(e)(2).
[621] Pub. L. No. 103–325.

attributable to certain financial property or to certain collectibles.[622]

The maximum annual amount of qualified equity investments is $3.5 billion for calendar years 2010 through 2019. No amount of unused allocation limitation may be carried to any calendar year after 2024.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the new markets tax credit, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

This provision provides that the new markets tax credit limitation is zero for calendar year 2018 and thereafter and no amount of unused allocation limitation may be carried to any calendar year after 2022.

EFFECTIVE DATE

The provision applies to calendar years beginning after December 31, 2017.

7. Repeal of credit for expenditures to provide access to disabled individuals (sec. 3407 of the bill and sec. 44 of the Code)

PRESENT LAW

Section 44 provides a 50-percent credit for eligible access expenditures paid or incurred by an eligible small business for the taxable year. The credit is limited to eligible access expenditures exceeding $250 but not exceeding 10,500. The credit is part of the general business credit.[623]

Eligible access expenditures generally means amounts paid or incurred by an eligible small business to comply with requirements under the Americans with Disabilities Act of 1990.[624] These expenditures[625] include: (1) removal of architectural, communication, physical or transportation barriers which prevent a business from being usable or accessible to individuals with disabilities;[626] (2) provision of qualified interpreters or other effective methods of making aurally-delivered materials available to individuals with hearing impairments; (3) provision of qualified readers, taped texts, or other effective methods of making visually-delivered materials available to individuals with visual impairments; (4) acquisition or modification of equipment or devices for individuals with disabil-

[622] Sec. 45D(d)(2).
[623] Sec. 38(b)(17).
[624] As in effect on November 5, 1990. Sec. 44(c)(1).
[625] These expenditures must be reasonable and necessary, excluding those unnecessary to accomplish listed purposes, and meet standards set forth by the Secretary and the Architectural and Transportation Barriers Compliance Board. Sec. 44(c)(3) and (5).
[626] Expenses related to this removal are not eligible in connection with facilities placed in service after November 5, 1990. Sec. 44(c)(4).

ities; or (5) provision of other similar services, modifications, materials, or equipment.

An eligible small business means any person that elects application of section 44 and, during the preceding taxable year, (1) had gross receipts not exceeding $1,000,000 or (2) employed not more than 30 full-time employees.[627]

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the credit for eligible access expenditures, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the credit for eligible access expenditures.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

8. Modification of credit for portion of employer social security taxes paid with respect to employee tips (sec. 3408 of the bill and sec. 45B of the Code)

PRESENT LAW

Credit

Certain food or beverage establishments may elect to claim a business tax credit equal to an employer's taxes under the Federal Insurance Contributions Act ("FICA")[628] paid on tips in excess of those treated as wages for purposes of meeting the minimum wage requirements of the Fair Labor Standards Act (the "FLSA") as in effect on January 1, 2007.[629] The credit applies only with respect to FICA taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary. The credit is available whether or not the tips are reported or a percentage of gross receipts is allocated (described below). No deduction is allowed for any amount taken into account in determining the tip credit. A taxpayer may elect not to have the credit apply for a taxable year.

[627] For this definition, an employee is considered full-time if employed at least 30 hours per week for 20 or more calendar weeks in the taxable year.

[628] FICA taxes consist of social security (OASDI, or old age, survivor, and disability insurance) and hospital (Medicare) taxes imposed on employers and employees with respect to wages paid to employees under sections 3101–3128.

[629] Sec. 45B. As of January 1, 2007, the Federal minimum wage under the FLSA was $5.15 per hour. In the case of tipped employees, the FLSA provided that the minimum wage could be reduced to $2.13 per hour (that is, the employer is only required to pay cash equal to $2.13 per hour) if the combination of tips and cash income equaled the Federal minimum wage.

Reporting and allocation requirements

Employees are required to report monthly tips to their employer.[630] Certain large[631] food or beverage establishments are required to report to the IRS and employees various information including gross receipts of the establishment, and to allocate among employees who customarily receive tip income an amount equal to eight percent of gross receipts in excess of the amount of tips reported by such employees.[632] Employee tip income that is reported by employees is treated as employer-provided wages subject to FICA.

REASONS FOR CHANGE

The Committee believes that updating the minimum wage threshold on which the FICA tip credit is determined, as well as requiring consistent reporting and tip allocations by businesses eligible for the credit, will encourage compliance and consistency among those food or beverage establishments that elect to claim the FICA tip credit.

EXPLANATION OF PROVISION

The provision revises the amount of the credit for FICA taxes an employer pays on tips, as an amount equal to the employer's FICA taxes paid on tips in excess of those treated as minimum wages under the FLSA without regard to the January 1, 2007 date. For 2017, this amount is $7.25. In addition, the credit is permitted only if the employer satisfies the reporting requirements of section 6053(c) to the IRS and employees, and allocates among employees who customarily receive tip income an amount equal to 10 percent (rather than eight percent) of gross receipts in excess of the amount of tips reported by such employees. The claiming of the credit remains elective. However, if any size eligible food or beverage establishment elects to claim the FICA tip credit for any taxable year after the provision takes effect, the establishment must satisfy this reporting and 10-percent allocation requirement for that taxable year. Reporting and allocation requirements for food and beverage establishments that elect not to claim the credit remain unchanged.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

[630] Sec. 6053(a).

[631] A large establishment for this purpose is one which normally employed more than 10 employees on a typical business day during the preceding calendar year.

[632] Sec. 6053(c).

F. ENERGY CREDITS

1. Modifications to credit for electricity produced from certain renewable resources (sec. 3501 of the bill and sec. 45 of the Code)

PRESENT LAW

In general

An income tax credit is allowed for the production of electricity from qualified energy resources at qualified facilities (the "renewable electricity production credit").[633] Qualified energy resources comprise wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, qualified hydropower production, and marine and hydrokinetic renewable energy. Qualified facilities are, generally, facilities that generate electricity using qualified energy resources. To be eligible for the credit, electricity produced from qualified energy resources at qualified facilities must be sold by the taxpayer to an unrelated person.

SUMMARY OF CREDIT FOR ELECTRICITY PRODUCED FROM CERTAIN RENEWABLE RESOURCES

Eligible electricity production activity (sec. 45)	Credit amount for 2017 (cents per kilowatt-hour)	Expiration [1]
Wind	2.4	December 31, 2019.
Closed-loop biomass	2.4	December 31, 2016.
Open-loop biomass (including agricultural livestock waste nutrient facilities).	1.2	December 31, 2016.
Geothermal	2.4	December 31, 2016.
Municipal solid waste (including landfill gas facilities and trash combustion facilities).	1.2	December 31, 2016.
Qualified hydropower	1.2	December 31, 2016.
Marine and hydrokinetic	1.2	December 31, 2016.

[1] Expires for property the construction of which begins after this date.

The credit rate, initially set at 1.5 cents per kilowatt-hour (reduced by one-half for certain renewable resources) is adjusted annually for inflation.[634] In general, the credit is available for electricity produced during the first 10 years after a facility has been placed in service.

Taxpayers may also elect to get a 30-percent investment tax credit in lieu of this production tax credit.[635]

Phase-down for wind facilities

In the case of wind facilities, the available production tax credit or investment tax credit is reduced by 20 percent for facilities the construction of which begins in 2017, by 40 percent for facilities the construction of which begins in 2018, and by 60 percent for facilities the construction of which begins in 2019.

[633] Sec. 45. In addition to the renewable electricity production credit, section 45 also provides income tax credits for the production of Indian coal and refined coal at qualified facilities.

[634] The most recent inflation adjustment factors can be found in IRS Notice 2017–33, I.R.B. 2017–22, May 30, 2017.

[635] Sec. 48(a)(5).

Special rules for determining when the construction of a facility begins

In general, a taxpayer may establish the beginning of construction of a facility by beginning physical work of a significant nature (the "physical work test").[636] Alternatively, a taxpayer may establish the beginning of construction by meeting the safe harbor test which generally requires that the taxpayer have paid or incurred five percent of the total cost of constructing the facility (the "five percent safe harbor").[637] Both methods require that a taxpayer make continuous progress towards completion once construction has begun.[638] To demonstrate that continuous progress is being made, taxpayers relying on the physical work test must show that the project is undergoing "continuous construction," and taxpayer relying on the five percent safe harbor must show "continuous effort" to complete the project.[639] Collectively, these two tests are referred to as the "continuity requirement."[640]

REASONS FOR CHANGE

The Committee believes that many existing tax incentives need to be repealed or otherwise limited as part of its larger tax reform effort to broaden the tax base, close loopholes and grow the economy. With this in mind, the Committee believes that it is appropriate to impose additional limits on the renewable power credit in order to make the tax system simpler and fairer for all individuals, families, and businesses, and to allow for lower tax rates. In addition, the Committee believes that codifying existing guidance regarding when the construction of a renewable power facility begins will provide increased certainty to taxpayers engaging in renewable power projects.

EXPLANATION OF PROVISION

The provision eliminates the inflation adjustment for wind facilities the construction of which begins after the date of enactment. Such facilities are entitled to a credit of 1.5 cents per kilowatt-hour (*i.e.*, the statutory credit rate unadjusted for inflation). Credits remain subject to the phase-down based on the year construction begins.

The provision includes a special rule for determining the beginning of construction, which is intended to codify Treasury guidance for determining when construction of a facility has begun, including the physical work test, the five percent safe harbor, and the continuity requirement.

EFFECTIVE DATE

The provision terminating the inflation adjustment is effective for taxable years ending after the date of enactment.

The provision codifying existing guidance for determining when construction has begun is effective for taxable years beginning before, on, or after the date of enactment.

[636] IRS Notice 2013–29, 2013–20 I.R.B. 1085, April 14, 2013.
[637] *Ibid.*
[638] *Ibid.* See also, Notice 2016–31, 2016–23 I.R.B. 1025, May 5, 2016.
[639] *Ibid.*
[640] Notice 2016–31, 2016–23 I.R.B. 1025, May 5, 2016.

2. Modification of the energy investment tax credit (sec. 3502 of the bill and sec. 48 of the Code)

PRESENT LAW

In general

A permanent, nonrefundable, 10-percent business energy credit[641] is allowed for the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat or (2) is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage. Property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

In addition to the permanent credit, temporary investment credits are available for a variety of renewable and alternative energy property. The rules governing these temporary credits are described below.

The energy credit is a component of the general business credit.[642] An unused general business credit generally may be carried back one year and carried forward 20 years.[643] The taxpayer's basis in the property is reduced by one-half of the amount of the credit claimed. For projects whose construction time is expected to equal or exceed two years, the credit may be claimed as progress expenditures are made on the project, rather than during the year the property is placed in service. The credit is allowed against the alternative minimum tax.

Solar energy property

The credit rate for solar energy property is increased to 30 percent in the case of property the construction of which begins before January 1, 2020. The rate is increased to 26 percent in the case of property the construction of which begins in calendar year 2020. The rate is increased to 22 percent in the case of property the construction of which begins in calendar year 2021. To qualify for the enhanced credit rates, the property must be placed in service before January 1, 2024.

Additionally, equipment that uses fiber-optic distributed sunlight ("fiber optic solar") to illuminate the inside of a structure is solar energy property eligible for the 30-percent credit, but only for property placed in service before January 1, 2017.

Fuel cell property and microturbine property

The energy credit applies to qualified fuel cell power plant property, but only for periods prior to January 1, 2017. The credit rate is 30 percent.

A qualified fuel cell power plant is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least one-half

[641] Sec. 48.
[642] Sec. 38(b)(1).
[643] Sec. 39.

kilowatt. The credit may not exceed $1,500 for each 0.5 kilowatt of capacity.

The energy credit applies to qualifying stationary microturbine power plant property for periods prior to January 1, 2017. The credit is limited to the lesser of 10 percent of the basis of the property or $200 for each kilowatt of capacity.

A qualified stationary microturbine power plant is an integrated system comprised of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency, and power factors. Such system must have an electricity-only generation efficiency of not less than 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts.

Geothermal heat pump property

The energy credit applies to qualified geothermal heat pump property placed in service prior to January 1, 2017. The credit rate is 10 percent. Qualified geothermal heat pump property is equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure.

Small wind property

The energy credit applies to qualified small wind energy property placed in service prior to January 1, 2017. The credit rate is 30 percent. Qualified small wind energy property is property that uses a qualified wind turbine to generate electricity. A qualifying wind turbine means a wind turbine of 100 kilowatts of rated capacity or less.

Combined heat and power property

The energy credit applies to combined heat and power ("CHP") property placed in service prior to January 1, 2017. The credit rate is 10 percent.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of not more than 67,000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

The otherwise allowable credit with respect to CHP property is reduced to the extent the property has an electrical capacity or mechanical capacity in excess of any applicable limits. Property in excess of the applicable limit (15 megawatts or a mechanical energy capacity of more than 20,000 horsepower or an equivalent combination of electrical and mechanical energy capacities) is permitted to claim a fraction of the otherwise allowable credit. The fraction is equal to the applicable limit divided by the capacity of the property. For example, a 45 megawatt property would be eligible to claim 15/45ths, or one third, of the otherwise allowable credit. Again, no credit is allowed if the property exceeds the 50 megawatt or 67,000 horsepower limitations described above.

Additionally, systems whose fuel source is at least 90 percent open-loop biomass and that would qualify for the credit but for the failure to meet the efficiency standard are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (i.e., a 5-percent credit).

Election of energy credit in lieu of section 45 production tax credit

A taxpayer may make an irrevocable election to have the property used in certain qualified renewable power facilities be treated as energy property eligible for a 30-percent investment credit under section 48. For this purpose, qualified facilities are facilities otherwise eligible for the renewable electricity production tax credit with respect to which no credit under section 45 has been allowed. A taxpayer electing to treat a facility as energy property may not claim the production credit under section 45. The 30-percent credit rate phases down in calendar years 2017, 2018, and 2019.

REASONS FOR CHANGE

In an effort to harmonize existing energy credits as part of tax reform, the Committee believes that the energy investment tax credit should have the same phase-down period and expiration date for otherwise credit-eligible property.

EXPLANATION OF PROVISION

The provision extends the energy credit for fiber optic solar, fuel cell, microturbine, geothermal heat pump, small wind, and combined heat and power property. In each case, the credit is extended for property the construction of which begins before January 1, 2022. In the case of fiber optic solar, fuel cell, and small wind property, the credit rate is reduced to 26 percent for property the construction of which begins in calendar year 2020 and to 22 percent for property the construction of which begins in calendar year 2021. Qualified property must be placed in service before January 1, 2024.

The provision terminates the permanent credits for solar and geothermal property the construction of which begins after December 31, 2027.

The provision adds a special rule for determining the beginning of construction of qualified property. Under the provision, the construction of any facility, modification, improvement, addition, or other property is not 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.

EFFECTIVE DATE

The provision generally applies to periods after December 31, 2016, under rules similar to the rules of section 48(m), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990. The extension of the credit for combined heat and power system property applies to property placed in service after December 31, 2016. The reduced credit rates and the termination of the permanent credits are effective on the date of the enactment of the provision. The special rule for determining the beginning of construction of qualified property applies to taxable years beginning before, on, or after the date of enactment of the provision.

3. Extension and phaseout of residential energy efficient property credit (sec. 3503 of the bill and sec. 25D of the Code)

PRESENT LAW

In general

Section 25D provides a personal tax 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.

Section 25D also provides 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 for any fuel cell may not exceed $500 for each 0.5 kilowatt of capacity.

The credit is nonrefundable. The credit with respect to all qualifying property may be claimed against the alternative minimum tax.

With the exception of solar property, the credit expires for property placed in service after December 31, 2016. In the case of qualified solar electric property and solar water heating property, the credit expires for property placed in service after December 31, 2021. In addition, the credit rate for such solar property is reduced to 26 percent for property placed in service in calendar year 2020 and to 22 percent for property placed in service in calendar year 2021.

Qualified property

Qualified solar electric property is property that uses solar energy to generate electricity for use in a dwelling unit. Qualifying solar water heating property is property used to heat water for use in a dwelling unit located in the United States and used as a residence if at least half of the energy used by such property for such purpose is derived from the sun.

A qualified fuel cell power plant is an integrated system comprised of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, (2) has an electricity-only generation efficiency of greater than 30 percent, and (3) has a nameplate capacity of at least 0.5 kilowatt. The qualified fuel cell power plant must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence.

Qualified small wind energy property is property that uses a wind turbine to generate electricity for use in a dwelling unit located in the United States and used as a residence by the taxpayer.

Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, (2) meets the requirements of the Energy Star program which are in effect at the time that the expenditure for such equipment is made, and (3) is installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.

Additional rules

The depreciable basis of the property is reduced by the amount of the credit. Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit are eligible expenditures.

Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

REASONS FOR CHANGE

In an effort to harmonize existing energy credits as part of tax reform, the Committee believes that the residential energy efficient property credit should have the same phase-down period and expiration date for all otherwise credit-eligible property.

EXPLANATION OF PROVISION

The provision extends the residential energy efficient property credit with respect to non-solar qualified property through December 31, 2021. The credit rate for such property is reduced to 26 percent for property placed in service in calendar year 2020 and to 22 percent for property placed in service in calendar year 2021.

EFFECTIVE DATE

The provision applies to property placed in service after December 31, 2016.

4. Repeal of enhanced oil recovery credit (sec. 3504 of the bill and sec. 43 of the Code)

PRESENT LAW

Section 43 provides a 15-percent credit for expenses associated with an enhanced oil recovery ("EOR") project. Qualified EOR costs consist of the following designated expenses associated with an EOR project: (1) amounts paid for depreciable tangible property; (2) intangible drilling and development expenses; (3) tertiary injectant expenses; and (4) construction costs for certain Alaskan natural gas treatment facilities. An EOR project is generally a project that involves increasing the amount of recoverable domestic crude oil through the use of one or more tertiary recovery methods (as defined in section 193(b)(3)), such as injecting steam or carbon dioxide into a well to effect oil displacement. The credit is reduced as the price of oil exceeds a certain threshold.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the enhanced oil recovery credit, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the enhanced oil recovery credit.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

5. Repeal of credit for producing oil and gas from marginal wells (sec. 3505 of the bill and sec. 45I of the Code)

PRESENT LAW

Section 45I provides a $3-per-barrel credit for the production of crude oil and a $0.50 credit per 1,000 cubic feet of qualified natural gas production. In both cases, the credit is available only for production from a "qualified marginal well."

A qualified marginal well is defined as a domestic well: (1) production from which is treated as marginal production for purposes of the Code's percentage depletion rules; or (2) that during the taxable year had average daily production of not more than 25 barrel equivalents and produces water at a rate of not less than 95 percent of total well effluent. The maximum amount of production on which credit could be claimed is 1,095 barrels or barrel equivalents.

The credit is not available to production occurring if the reference price of oil exceeds $18 ($2.00 for natural gas). The credit is reduced proportionately for reference prices between $15 and $18 ($1.67 and $2.00 for natural gas).

The credit is treated as a general business credit. Unused credits can be carried back for up to five years rather than the generally applicable carryback period of one year. The credit is indexed for inflation.

REASONS FOR CHANGE

The Committee believes that the repeal of many existing tax incentives, including the credit for producing oil and gas from marginal wells, makes the system simpler and fairer for all individuals, families, and businesses, and allows for lower tax rates. The Committee further believes that the repeal of this provision is an important part of its larger tax reform effort.

EXPLANATION OF PROVISION

The provision repeals the credit for producing oil and gas from marginal wells.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

6. Modification of credit for production from advanced nuclear power facilities (sec. 3506 of the bill and sec. 45J of the Code)

PRESENT LAW

Taxpayers producing electricity at a qualifying advanced nuclear power facility may claim a credit equal to 1.8 cents per kilowatt-hour of electricity produced for the eight-year period starting when the facility is placed in service.[644] The aggregate amount of credit that a taxpayer may claim in any year during the eight-year period is subject to limitation based on allocated capacity and an annual limitation as described below.

An advanced nuclear facility is any nuclear facility for the production of electricity, the reactor design for which was approved after 1993 by the Nuclear Regulatory Commission. For this purpose, a qualifying advanced nuclear facility does not include any facility for which a substantially similar design for a facility of comparable capacity was approved before 1994.

A qualifying advanced nuclear facility is an advanced nuclear facility for which the taxpayer has received an allocation of megawatt capacity from the Secretary of the Treasury ("the Secretary") and is placed in service before January 1, 2021. The taxpayer may only claim credit for production of electricity equal to the ratio of the allocated capacity that the taxpayer receives from the Secretary to the rated nameplate capacity of the taxpayer's facility. For example, if the taxpayer receives an allocation of 750 megawatts of capacity from the Secretary and the taxpayer's facility has a rated nameplate capacity of 1,000 megawatts, then the taxpayer may claim three-quarters of the otherwise allowable credit, or 1.35 cents per kilowatt-hour, for each kilowatt-hour of electricity produced at the facility (subject to the annual limitation described below). The credit is restricted to 6,000 megawatts of national capacity. Once that limitation has been reached, the Secretary may make no additional allocations. Treasury guidance required allocation applications to be filed before February 1, 2014.[645]

A taxpayer operating a qualified facility may claim no more than $125 million in tax credits per 1,000 megawatts of allocated capacity in any one year of the eight-year credit period. If the taxpayer operates a 1,350 megawatt rated nameplate capacity system and

[644] Sec. 45J. The 1.8-cents credit amount is reduced, but not below zero, if the annual average contract price per kilowatt-hour of electricity generated from advanced nuclear power facilities in the preceding year exceeds eight cents per kilowatt-hour. The eight-cent price comparison level is indexed for inflation after 1992 (12.6 cents for 2017).

[645] I.R.S. Notice 2013–68.

has received an allocation from the Secretary for 1,350 megawatts of capacity eligible for the credit, the taxpayer's annual limitation on credits that may be claimed is equal to 1.35 times $125 million, or $168.75 million. If the taxpayer operates a facility with a nameplate rated capacity of 1,350 megawatts, but has received an allocation from the Secretary for 750 megawatts of credit eligible capacity, then the two limitations apply such that the taxpayer may claim a credit effectively equal to one cent per kilowatt-hour of electricity produced (calculated as described above) subject to an annual credit limitation of $93.75 million in credits (three-quarters of $125 million).

The credit is part of the general business credit.

REASONS FOR CHANGE

The Committee is concerned that some advanced nuclear power credits that would otherwise be available to taxpayers may go unused. Specifically, the Committee wants to ensure the full utilization of all 6,000 megawatts of credit-eligible advanced nuclear power national capacity by requiring unutilized capacity to be reallocated. In addition, the Committee wants to ensure that tax-exempt entities receiving credit allocations may elect to transfer those credits to other participants in an advanced nuclear power project. The Committee therefore believes that some modifications to the advanced nuclear power credit are necessary.

EXPLANATION OF PROVISION

The provision modifies the national megawatt capacity limitation for the advanced nuclear power production credit. To the extent any amount of the 6,000 megawatts of authorized capacity remains unutilized, the provision requires the Secretary to allocate such capacity first to facilities placed in service before the year 2021, to the extent such facilities did not receive an allocation equal to their full nameplate capacity, and then to facilities placed in service after such date in the order in which such facilities are placed in service. The provision provides that the present-law placed-in-service sunset date of January 1, 2021, does not apply with respect to allocations of such unutilized national megawatt capacity.

The provision also allows qualified public entities to elect to forgo credits to which they otherwise would be entitled in favor of an eligible project partner. Qualified public entities are defined as (1) a Federal, State, or local government of any political subdivision, agency, or instrumentality thereof; (2) a mutual or cooperative electric company; or (3) a not-for-profit electric utility which has or had received a loan or loan guarantee under the Rural Electrification Act of 1936.[646] An eligible project partner under the provision generally includes any person who designed or constructed the nuclear power plant, participates in the provision of nuclear steam or nuclear fuel to the power plant, or has an ownership interest in the facility. In the case of a facility owned by a partnership, where the credit is determined at the partnership level, any electing qualified public entity is treated as the taxpayer with respect to such entity's

[646] 7 U.S.C. sec. 901 et seq.

distributive share of such credits, and any other partner is an eligible project partner.

EFFECTIVE DATE

The provision requiring the allocation of unutilized national megawatt capacity limitation is effective on the date of enactment. The provision allowing an election by qualified public entities to forgo credits in favor of an eligible project partner is effective for taxable years beginning after the date of enactment.

G. Bond Reforms

1. Termination of private activity bonds (sec. 3601 of the bill and sec. 103 of the Code)

PRESENT LAW

In general

Under present law, gross income generally does not include interest paid on State or local bonds.[647] State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds which are primarily used to finance governmental functions or that are repaid with governmental funds. Private activity bonds are bonds with respect to which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.*, private businesses or individuals). The exclusion from income for State and local bonds only applies to private activity bonds if the bonds are issued for certain permitted purposes ("qualified private activity bonds").

Private activity bonds

Present law provides three main tests for determining whether a State or local bond is in substance a private activity bond, the two-part private business test, the five-percent unrelated or disproportionate use test, and the private loan test.

Private business test

Private business use and private payments result in State and local bonds being private activity bonds if both parts of the two-part private business test are satisfied—

1. More than 10 percent of the bond proceeds is to be used (directly or indirectly) by a private business (the "private business use test"); and
2. More than 10 percent of the debt service on the bonds is secured by an interest in property to be used in a private business use or to be derived from payments in respect of such property (the "private payment test").

Private business use generally includes any use by a business entity (including the Federal government), which occurs pursuant to terms not generally available to the general public. For example, if bond-financed property is leased to a private business (other than pursuant to certain short-term leases for which safe harbors are provided under Treasury regulations), bond proceeds used to finance the property are treated as used in a private business use,

[647] Sec. 103.

and rental payments are treated as securing the payment of the bonds. Private business use also can arise when a governmental entity contracts for the operation of a governmental facility by a private business under a management contract that does not satisfy Treasury regulatory safe harbors regarding the types of payments made to the private operator and the length of the contract.

Five-percent unrelated or disproportionate business use test

A second standard to determine whether a bond is to be treated as a private activity bond is the five percent unrelated or disproportionate business use test. Under this test the private business use and private payment test (described above) are separately applied substituting five percent for 10 percent and generally only taking into account private business use and private payments that are not related or not proportionate to the government use of the bond proceeds. For example, while a bond issue that finances a new State or local government office building may include a cafeteria, the issue may become a private activity bond if the size of the cafeteria is excessive (as determined under this rule).

Private loan test

The third standard for determining whether a State or local bond is a private activity bond is whether an amount exceeding the lesser of (1) five percent of the bond proceeds or (2) $5 million is used (directly or indirectly) to finance loans to private persons. Private loans include both business and other (*e.g.,* personal) uses and payments by private persons; however, in the case of business uses and payments, all private loans also constitute private business uses and payments subject to the private business test. Present law provides that the substance of a transaction governs in determining whether the transaction gives rise to a private loan. In general, any transaction which transfers tax ownership of property to a private person is treated as a private loan.

Special limit on certain output facilities

A special rule for output facilities treats bonds as private activity bonds if more than $15 million of the proceeds of the bond issue are used to finance an output facility (an output facility includes electric and gas generation, transmission and related facilities but not a facility for the furnishing of water).[648]

Special volume cap requirement for larger transactions

A special volume cap requirement for larger transactions treats bonds as private activity bonds if the nonqualified amount of private business use or private payments exceeds $15 million (even if that amount is within the general 10-percent private business limitation for governmental bonds) unless the issuer obtains a private activity bond volume allocation.[649]

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds.

[648] Sec. 141(b)(4).
[649] Sec. 141(b)(5).

Qualified private activity bonds permit States or local governments to act as conduits providing tax-exempt financing for certain private activities. The definition of qualified private activity bonds includes an exempt facility bond, or qualified mortgage, veterans' mortgage, small issue, redevelopment, 501(c)(3), or student loan bond.[650] The definition of exempt facility bond includes bonds issued to finance certain transportation facilities (airports, ports, mass commuting, and high-speed intercity rail facilities); qualified residential rental projects; privately owned and/or operated utility facilities (sewage, water, solid waste disposal, and local district heating and cooling facilities, certain private electric and gas facilities, and hydroelectric dam enhancements); public/private educational facilities; qualified green building and sustainable design projects; and qualified highway or surface freight transfer facilities.[651]

In most cases, the aggregate volume of these tax-exempt private activity bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. For 2017, the State volume limit is the greater of $100 multiplied by the State population, or $305.32 million.[652]

REASONS FOR CHANGE

The Committee believes that the Federal government should not subsidize the borrowing costs of private businesses, allowing them to pay lower interest rates, while competitors with similar creditworthiness that are unable to avail themselves of qualified private activity bonds must pay a higher interest rate on the debt they issue. The Committee believes that if taxpayers in a State or locality decide to subsidize private businesses those taxpayers should bear the cost of those subsidies, instead of all Federal taxpayers bearing a portion of the cost.

EXPLANATION OF PROVISION

The provision repeals the exception from the exclusion from gross income for interest paid on qualified private activity bonds issued after December 31, 2017. Thus, such interest on private activity bond issued after such date is includible in the gross income of the taxpayer.[653]

EFFECTIVE DATE

The provision applies to bonds issued after December 31, 2017.

2. Repeal of advance refunding bonds (sec. 3602 of the bill and sec. 149(d) of the Code)

PRESENT LAW

Section 103 generally provides that gross income does not include interest received on State or local bonds. State and local bonds are

[650] Sec. 141(e).
[651] Sec. 142(a).
[652] Sec. 3.20 of Rev. Proc. 2016–55, 2016–2 C.B. 707.
[653] The provisions do not apply to any previously issued bond, nor would the provisions prevent State and local governments from issuing private activity bonds in the future; the provisions merely remove the Federal tax subsidy for newly issued bonds. The bill also terminates section 25 of the Code as it relates to credits associated with mortgage credit certificates issued after December 31, 2017. See section 1102 of the bill (Repeal of nonrefundable credits).

classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.,* private businesses or individuals).[654] Bonds issued to finance the activities of charitable organizations described in section 501(c)(3) ("qualified 501(c)(3) bonds") are one type of private activity bond. The exclusion from income for interest on State and local bonds only applies if certain Code requirements are met.

The exclusion for income for interest on State and local bonds applies to refunding bonds but there are limits on advance refunding bonds. A refunding bond is defined as any bond used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond). Different rules apply to current as opposed to advance refunding bonds. A current refunding occurs when the refunded bond is redeemed within 90 days of issuance of the refunding bonds. Conversely, a bond is classified as an advance refunding if it is issued more than 90 days before the redemption of the refunded bond.[655] Proceeds of advance refunding bonds are generally invested in an escrow account and held until a future date when the refunded bond may be redeemed.

Although there is no statutory limitation on the number of times that tax-exempt bonds may be currently refunded, the Code limits advance refundings. Generally, governmental bonds and qualified 501(c)(3) bonds may be advance refunded one time.[656] Private activity bonds, other than qualified 501(c)(3) bonds, may not be advance refunded at all.[657] Furthermore, in the case of an advance refunding bond that results in interest savings (*e.g.*, a high interest rate to low interest rate refunding), the refunded bond must be redeemed on the first call date 90 days after the issuance of the refunding bond that results in debt service savings.[658]

REASONS FOR CHANGE

The ability to issue advance refunding bonds allows State and local governments to issue and have outstanding two sets of Federally subsidized debt associated with the same activity. The Committee believes that a single activity should have a maximum of only one set of Federally subsidized debt, and so believes removing the ability to issue tax-advantaged advance refunding bonds is appropriate.

EXPLANATION OF PROVISION

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

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[654] Sec. 141.
[655] Sec. 149(d)(5).
[656] Sec. 149(d)(3). Bonds issued before 1986 and pursuant to certain transition rules contained in the Tax Reform Act of 1986 may be advance refunded more than one time in certain cases.
[657] Sec. 149(d)(2).
[658] Sec. 149(d)(3)(A)(iii) and (B); Treas. Reg. sec. 1.149(d)–1(f)(3). A "call" provision provides the issuer of a bond with the right to redeem the bond prior to the stated maturity.

EFFECTIVE DATE

The provision applies to advance refunding bonds issued after December 31, 2017.

3. Repeal of tax credit bonds (sec. 3603 of the bill and secs. 54A, 54B, 54C, 54D, 54E, 54F and 6431 of the Code)

PRESENT LAW

In general

Tax-credit bonds provide tax credits to investors to replace a prescribed portion of the interest cost. The borrowing subsidy generally is measured by reference to the credit rate set by the Treasury Department. Current tax-credit bonds include qualified tax credit bonds, which have certain common general requirements, and include new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds.[659]

Qualified tax-credit bonds

General rules applicable to qualified tax-credit bonds[660]

Unlike tax-exempt bonds, qualified tax-credit bonds generally are not interest-bearing obligations. Rather, the taxpayer holding a qualified tax-credit bond on a credit allowance date is entitled to a tax credit. The amount of the credit is determined by multiplying the bond's credit rate by the face amount on the holder's bond. The credit rate for an issue of qualified tax credit bonds is determined by the Secretary and is estimated to be a rate that permits issuance of the qualified tax-credit bonds without discount and interest cost to the qualified issuer.[661] The credit accrues quarterly and is includible in gross income (as if it were an interest payment on the bond), and can be claimed against regular income tax liability and alternative minimum tax liability. Unused credits may be carried forward to succeeding taxable years. In addition, credits may be separated from the ownership of the underlying bond similar to how interest coupons can be stripped for interest-bearing bonds.

New clean renewable energy bonds

New clean renewable energy bonds ("New CREBs") may be issued by qualified issuers to finance qualified renewable energy facilities.[662] Qualified renewable energy facilities are facilities that: (1) qualify for the tax credit under section 45 (other than Indian coal and refined coal production facilities), without regard to the placed-in-service date requirements of that section; and (2) are

[659] The authority to issue two other types of tax-credit bonds, recovery zone economic development bonds and Build America Bonds, expired on January 1, 2011.

[660] Certain other rules apply to qualified tax credit bonds, such as maturity limitations, reporting requirements, spending rules, and rules relating to arbitrage. Separate rules apply in the case of tax-credit bonds which are not qualified tax-credit bonds (*i.e.,* "recovery zone economic development bonds," and "Build America Bonds").

[661] However, for new clean renewable energy bonds and qualified energy conservation bonds, the applicable credit rate is 70 percent of the otherwise applicable rate.

[662] Sec. 54C.

owned by a public power provider, governmental body, or cooperative electric company.

The term "qualified issuers" includes: (1) public power providers; (2) a governmental body; (3) cooperative electric companies; (4) a not-for-profit electric utility that has received a loan or guarantee under the Rural Electrification Act; and (5) clean renewable energy bond lenders. There was originally a national limitation for New CREBs of $800 million. The national limitation was then increased by an additional $1.6 billion in 2009. As with other tax credit bonds, a taxpayer holding New CREBs on a credit allowance date is entitled to a tax credit. However, the credit rate on New CREBs is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer.[663]

Qualified energy conservation bonds

Qualified energy conservation bonds may be used to finance qualified conservation purposes.

The term "qualified conservation purpose" means:

1. Capital expenditures incurred for purposes of: (a) reducing energy consumption in publicly owned buildings by at least 20 percent; (b) implementing green community programs;[664] (c) rural development involving the production of electricity from renewable energy resources; or (d) any facility eligible for the production tax credit under section 45 (other than Indian coal and refined coal production facilities);
2. Expenditures with respect to facilities or grants that support research in: (a) development of cellulosic ethanol or other nonfossil fuels; (b) technologies for the capture and sequestration of carbon dioxide produced through the use of fossil fuels; (c) increasing the efficiency of existing technologies for producing nonfossil fuels; (d) automobile battery technologies and other technologies to reduce fossil fuel consumption in transportation; and (e) technologies to reduce energy use in buildings;
3. Mass commuting facilities and related facilities that reduce the consumption of energy, including expenditures to reduce pollution from vehicles used for mass commuting;
4. Demonstration projects designed to promote the commercialization of: (a) green building technology; (b) conversion of agricultural waste for use in the production of fuel or otherwise; (c) advanced battery manufacturing technologies; (d) technologies to reduce peak-use of electricity; and (e) technologies for the capture and sequestration of carbon dioxide emitted from combusting fossil fuels in order to produce electricity; and

[663] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

[664] Capital expenditures to implement green community programs include grants, loans, and other repayment mechanisms to implement such programs. For example, States may issue these tax credit bonds to finance retrofits of existing private buildings through loans and/or grants to individual homeowners or businesses, or through other repayment mechanisms. Other repayment mechanisms can include periodic fees assessed on a government bill or utility bill that approximates the energy savings of energy efficiency or conservation retrofits. Retrofits can include heating, cooling, lighting, water-saving, storm water-reducing, or other efficiency measures.

5. Public education campaigns to promote energy efficiency (other than movies, concerts, and other events held primarily for entertainment purposes).

There was originally a national limitation on qualified energy conservation bonds of $800 million. The national limitation was then increased by an additional $2.4 billion in 2009. As with other qualified tax credit bonds, the taxpayer holding qualified energy conservation bonds on a credit allowance date is entitled to a tax credit. The credit rate on the bonds is set by the Secretary at a rate that is 70 percent of the rate that would permit issuance of such bonds without discount and interest cost to the issuer.[665]

Qualified zone academy bonds

Qualifies zone academy bonds ("QZABs") are defined as any bond issued by a State or local government, provided that (1) at least 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy," and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A total of $400 million of QZABs has been authorized to be issued annually in calendar years 1998 through 2008. The authorization was increased to $1.4 billion for calendar year 2009, and also for calendar year 2010. For each of the calendar years 2011 through 2016, the authorization was set at $400 million.

Qualified school construction bonds

Qualified school construction bonds must meet three requirements: (1) 100 percent of the available project proceeds of the bond issue is used for the construction, rehabilitation, or repair of a public school facility or for the acquisition of land on which such a bond-financed facility is to be constructed; (2) the bonds are issued by a State or local government within which such school is located; and (3) the issuer designates such bonds as a qualified school construction bond.

There is a national limitation on qualified school construction bonds of $11 billion for calendar years 2009 and 2010, and zero after 2010. If an amount allocated is unused for a calendar year, it may be carried forward to the following and subsequent calendar years. Under a separate special rule, the Secretary of the Interior may allocate $200 million of school construction bond authority for Indian schools.

Direct-pay bonds and expired tax-credit bond provisions

The Code provides that an issuer may elect to issue certain tax credit bonds as "direct-pay bonds." Instead of a credit to the holder, with a "direct-pay bond" the Federal government pays the issuer a percentage of the interest on the bonds. The following tax credit bonds may be issued as direct-pay bonds: new clean renewable energy bonds, qualified energy conservation bonds, and qualified

[665] Given the differences in credit quality and other characteristics of individual issuers, the Secretary cannot set credit rates in a manner that will allow each issuer to issue tax credit bonds at par.

school construction bonds. Qualified zone academy bonds may not be issued as direct-pay using any national zone academy bond allocation for calendar years after 2011 or any carryforward of such allocations. The ability to issue Build America Bonds and Recovery Zone bonds, which have direct-pay features, has expired.

REASONS FOR CHANGE

The Committee believes that some tax credit bond programs allow for financing of activities that may be of questionable value to Federal taxpayers. In any case, the Committee believes that sufficient time has passed to allow full use of the allocations provided for under tax-credit bond programs and that terminating the issuance of new tax credit bonds is appropriate.

EXPLANATION OF PROVISION

The provision prospectively repeals authority to issue tax-credit bonds and direct-pay bonds.

EFFECTIVE DATE

The provision applies to bonds issued after December 31, 2017.

4. No tax-exempt bonds for professional stadiums (sec. 3604 of the bill and sec. 103 of the Code)

PRESENT LAW

In general

Section 103 generally provides gross income does not include interest on State or local bonds. State and local bonds are classified generally as either governmental bonds or private activity bonds. Governmental bonds are bonds the proceeds of which are primarily used to finance governmental facilities or the debt is repaid with governmental funds. Private activity bonds are bonds in which the State or local government serves as a conduit providing financing to nongovernmental persons (*e.g.,* private businesses or individuals). The exclusion from income for State and local bonds does not apply to private activity bonds, unless the bonds are issued for certain purposes ("qualified private activity bonds") permitted by the Code and other Code requirements are met.

Private activity bond tests

In general

A private activity bond includes any bond that satisfies (1) the "private business test" (consisting of two components: a private business use test and a private security or payment test); or (2) "the private loan financing test." [666]

Two-part private business test

Under the private business test, a bond is a private activity bond if it is part of an issue in which:

(1) More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the

[666] Sec. 141.

trade or business of any person other than a governmental unit ("private business use test"); and

(2) More than 10 percent of the payment of principal or interest on the issue is, directly or indirectly, secured by (a) property used or to be used for a private business use or (b) to be derived from payments in respect of property, or borrowed money, used or to be used for a private business use ("private payment test").[667]

A bond is not a private activity bond unless both parts of the private business test (*i.e.,* the private business use test *and* the private payment test) are met. For purposes of the private payment test, both direct and indirect payments made by any private person treated as using the financed property are taken into account. Payments by a person for the use of proceeds generally do not include payments for ordinary and necessary expenses (within the meaning of section 162) attributable to the operation and maintenance of financed property.[668]

Private loan financing test

A bond issue satisfies the private loan financing test if proceeds exceeding the lesser of $5 million or five percent of such proceeds are used directly or indirectly to finance loans to one or more nongovernmental persons.

Types of qualified private activity bonds

The interest of qualified private activity bonds is tax exempt. A qualified private activity bond is a qualified mortgage, veterans' mortgage, small issue, student loan, redevelopment, 501(c)(3), or exempt facility bond.[669] To qualify as an exempt facility bond, 95 percent of the net proceeds must be used to finance: (1) airports; (2) docks and wharves; (3) mass commuting facilities; (4) high-speed intercity rail facilities; (5) facilities for the furnishing of water; (6) sewage facilities; (7) solid waste disposal facilities; (8) hazardous waste disposal facilities; (9) qualified residential rental projects; (10) facilities for the local furnishing of electric energy or gas; (11) local district heating or cooling facilities; (12) environmental enhancements of hydroelectric generating facilities; (13) qualified public educational facilities; or (14) qualified green building and sustainable design projects.

Financing of sports facilities with governmental bonds

In 1986, Congress eliminated a provision expressly allowing tax-exempt financing for sports facilities.[670] Nevertheless, professional sports facilities continue to be financed with tax-exempt bonds despite the fact that privately owned sports teams are the primary (if not exclusive) users of such facilities. Present law permits the use of tax-exempt bond proceeds for private activities if either part of the two-part private business test is not met. Only if both parts

[667] The 10-percent private business test is reduced to five percent in the case of private business uses (and payments with respect to such uses) that are unrelated to any governmental use being financed by the issue.

[668] Treas. Reg. sec. 1.141–4(c)(3).

[669] Sec. 141(e).

[670] Sec. 1301 of the Tax Reform Act of 1986 (Pub. L. 99–514, 1986) (prior to amendment, sec. 103(b)(4)(B) of the Internal Revenue Code of 1954 permitted tax-exempt financing for sports facilities).

of the private business test (private use and private payment) are met will the interest on such bonds be taxable. In the case of bond-financed professional sports facilities, issuers have intentionally structured the tax-exempt bond issuance and related transactions to fail the private payment test. In most of these transactions, the professional sports team is not required to pay for more than a small portion of its use of the sports facility. As a result, the private payment test is not met and the bonds financing the facility are not treated as private activity bonds, despite the existence of substantial private business use.

REASONS FOR CHANGE

Congress attempted to eliminate tax-exempt financing for sports facilities in the Tax Reform Act of 1986. Despite that effort, however, such financings have continued, and the Committee believes it is appropriate to close the loophole that allows tax-exempt financing of stadiums for the benefit of professional sports teams.

EXPLANATION OF PROVISION

The provision provides that the interest on bonds, the proceeds of which are to be used to finance or refinance capital expenditures allocable to a professional sports stadium, is not tax-exempt. The term "professional sports stadium" means any facility (or appurtenant real property) which during at least five days during any calendar year is used as a stadium or arena for professional sports, exhibitions, games, or training.

EFFECTIVE DATE

The provision applies to bonds issued after November 2, 2017.

H. INSURANCE

1. Net operating losses of life insurance companies (sec. 3701 of the bill and sec. 810 of the Code)

PRESENT LAW

A net operating loss ("NOL") generally means the amount by which a taxpayer's business deductions exceed its gross income. In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years. NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[671]

For purposes of computing the alternative minimum tax ("AMT"), a taxpayer's NOL deduction cannot reduce the taxpayer's alternative minimum taxable income ("AMTI") by more than 90 percent of the AMTI.[672]

In the case of a life insurance company, a deduction is allowed in the taxable year for operations loss carryovers and carrybacks, in lieu of the deduction for net operation losses allowed to other corporations.[673] A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any tax-

[671] Sec. 172(b)(2).
[672] Sec. 56(d).
[673] Secs. 810, 805(a)(5).

able year as an operations loss carryback to each of the three taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[674]

REASONS FOR CHANGE

The Committee believes that the treatment of loss carryovers of life insurance companies should not differ from the treatment of NOL carryovers of other corporations. Consequently, the Committee bill eliminates the separate life insurer carryover rules and applies the generally applicable NOL rules to life insurance companies.

EXPLANATION OF PROVISION

The provision repeals the operations loss deduction for life insurance companies and allows the NOL deduction under section 172. This provides the same treatment for losses of life insurance companies as for losses of property and casualty insurance companies and of other corporations. The provision thus limits the companies' NOL deduction to 90 percent of taxable income (determined without regard to the deduction), provides that carryovers to other years are adjusted to take account of this limitation and may be carried forward indefinitely with interest, and repeals the present-law three-year carryback. The NOL deduction of a life insurance company is determined by treating the NOL for any taxable year generally as the excess of the life insurance deductions for such taxable year over the life insurance gross income for such taxable year.

EFFECTIVE DATE

The provision applies to losses arising in taxable years beginning after December 31, 2017.

2. Repeal of small life insurance company deduction (sec. 3702 of the bill and sec. 806 of the Code)

PRESENT LAW

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

REASONS FOR CHANGE

The Committee believes that the small life insurance company deduction may have served as a transition rule effectively providing a corporate tax rate reduction to small life insurers in connection with 1984 changes to the rules governing life insurance company taxation. However, that purpose has been obviated by the

[674] Sec. 810(b)(1).

passage of time. The Committee believes that in light of the reduction in the corporate income tax rate to 20 percent, it is appropriate to eliminate the small life insurance company deduction.

EXPLANATION OF PROVISION

The provision repeals the small life insurance company deduction.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

3. Surtax on life insurance company taxable income (sec. 3703 of the bill and sec. 801 of the Code)

PRESENT LAW

Tax on life insurance company taxable income

In the case of a life insurance company, income tax is imposed on life insurance company taxable income at the rate applicable to taxable income of a corporation.

Reserves

In determining life insurance company taxable income, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves.[675] Methods for determining reserves for tax purposes generally are based on reserves prescribed by the National Association of Insurance Commissioners for purposes of financial reporting under State regulatory rules.

In computing the net increase or net decrease in reserves, six items are taken into account. These are (1) life insurance reserves; (2) unearned premiums and unpaid losses included in total reserves; (3) amounts that are discounted at interest to satisfy obligations under insurance and annuity contracts that do not involve life, accident, or health contingencies when the computation is made; (4) dividend accumulations and other amounts held at interest in connection with insurance and annuity contracts; (5) premiums received in advance and liabilities for premium deposit funds; and (6) reasonable special contingency reserves under contracts of group term life insurance or group accident and health insurance that are held for retired lives, premium stabilization, or a combination of both.

Life insurance reserves for any contract are the greater of the net surrender value of the contract or the reserves determined under Federally prescribed rules, but may not exceed the statutory reserve with respect to the contract (for regulatory reporting). In computing the Federally prescribed reserve for any type of contract, the taxpayer must use the tax reserve method applicable to the contract, an interest rate for discounting of reserves to take account of the time value of money, and the prevailing commissioners' standard tables for mortality or morbidity. The assumed interest rate to be used in computing the Federally prescribed re-

[675] Sec. 807.

serve is the greater of the applicable Federal interest rate or the prevailing State assumed interest rate.

Proration rules

A life insurance company is subject to proration rules in calculating life insurance company taxable income.

The proration rules reduce the company's deductions, including reserve deductions and dividends received deductions, if the life insurance company has tax-exempt income, deductible dividends received, or other similar untaxed income items, because deductible reserve increases can be viewed as being funded proportionately out of taxable and tax-exempt income.

Under the proration rules, the net increase and net decrease in reserves are computed by reducing the ending balance of the reserve items by the policyholders' share of tax-exempt interest.[676]

Similarly, under the proration rules, a life insurance company is allowed a dividends-received deduction for intercorporate dividends from nonaffiliates only in proportion to the company's share of such dividends,[677] but not for the policyholders' share. Fully deductible dividends from affiliates are excluded from the application of this proration formula, if such dividends are not themselves distributions from tax-exempt interest or from dividend income that would not be fully deductible if received directly by the taxpayer. In addition, the proration rule includes in prorated amounts the increase for the taxable year in policy cash values of life insurance policies and annuity and endowment contracts.

Company's share and policyholder's share under proration rules

The life insurance company proration rules provide that the company's share, for this purpose, means the percentage obtained by dividing the company's share of the net investment income for the taxable year by the net investment income for the taxable year.[678] Net investment income means 95 percent of gross investment income, in the case of assets held in segregated asset accounts under variable contracts, and 90 percent of gross investment income in other cases.[679]

Gross investment income includes specified items.[680] The specified items include interest (including tax-exempt interest), dividends, rents, royalties and other related specified items, short-term capital gains, and trade or business income. Gross investment income does not include gain (other than short-term capital gain to the extent it exceeds net long-term capital loss) that is, or is considered as, from the sale or exchange of a capital asset. Gross investment income also does not include the appreciation in the value of assets that is taken into account in computing the company's tax reserve deduction under section 817.

The company's share of net investment income, for purposes of this calculation, is the net investment income for the taxable year, reduced by the sum of (a) the policy interest for the taxable year

[676] Secs. 807(a)(2)(B) and (b)(1)(B).
[677] Secs. 805(a)(4), 812.
[678] Sec. 812(a).
[679] Sec. 812(c).
[680] Sec. 812(d).

and (b) a portion of policyholder dividends.[681] Policy interest is defined to include required interest at the greater of the prevailing State assumed rate or the applicable Federal rate (plus some other interest items). Present law provides that in any case where neither the prevailing State assumed interest rate nor the applicable Federal rate is used, "another appropriate rate" is used for this calculation. No statutory definition of "another appropriate rate" is provided; the law is unclear as to what rate or rates are appropriate for this purpose.[682]

In 2007, the IRS issued Rev. Rul. 2007–54,[683] interpreting required interest under section 812(b) to be calculated by multiplying the mean of a contract's beginning-of-year and end-of-year reserves by the greater of the applicable Federal interest rate or the prevailing State assumed interest rate, for purposes of determining separate account reserves for variable contracts. However, Rev. Rul. 2007–54 was suspended by Rev. Rul. 2007–61, in which the IRS and the Treasury Department stated that the issues would more appropriately be addressed by regulation.[684] No regulations have been issued to date.

Capitalization of policy acquisition expenses

In the case of an insurance company, specified policy acquisition expenses for any taxable year are required to be capitalized, and generally are amortized over the 120-month period beginning with the first month in the second half of the taxable year.[685]

Specified policy acquisition expenses are determined as that portion of the insurance company's general deductions for the taxable year that does not exceed a specific percentage of the net premiums for the taxable year on each of three categories of insurance contracts. For annuity contracts, the percentage is 1.75; for group life insurance contracts, the percentage is 2.05; and for all other specified insurance contracts, the percentage is 7.7.

With certain exceptions, a specified insurance contract is any life insurance, annuity, or noncancellable accident and health insurance contract or combination thereof. A group life insurance contract is any life insurance contract that covers a group of individuals defined by reference to employment relationship, membership in an organization, or similar factor, the premiums for which are determined on a group basis, and the proceeds of which are payable to (or for the benefit of) persons other than the employer of the insured, an organization to which the insured belongs, or other similar person.

[681] Sec. 812(b)(1). This portion is defined as gross investment income's share of policyholder dividends.

[682] Legislative history of section 812 mentions that the general concept that items of investment yield should be allocated between policyholders and the company was retained from prior law. H. Rep. 98–861. Conference Report to accompany H.R. 4170, the Deficit Reduction Act of 1984, 98th Cong., 2d Sess., 1065 (June 23, 1984). This concept is referred to in Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, JCS–41–84, p. 622, stating, "[u]nder the Act, the formula used for purposes of determining the policyholders' share in based generally on the proration formula used under prior law in computing gain or loss from operations (i.e., by reference to 'required interest')." This may imply that a reference to pre-1984-law regulations may be appropriate. See Rev. Rul 2003-120, 2003-2 C.B. 1154, and Technical Advice Memoranda 20038008 and 20339049.

[683] 2007–38 I.R.B. 604.

[684] 2007–42 I.R.B. 799.

[685] Sec. 848.

REASONS FOR CHANGE

The Committee bill provides for a reduction to 20 percent of the rate of tax applicable to corporations, including to life insurance companies. In connection with the reduction in the corporate tax rate, the Committee believes it is timely and appropriate to update present-law tax provisions governing life insurers, including those relating to computation of life insurance tax reserves, life insurance proration for purposes of determining the dividends received deduction, and capitalization of policy acquisition expenses. The Committee is concerned that these provisions are out of date and do not reflect recent developments. The Committee is continuing to develop reforms to these provisions. In the meantime, the bill includes a surtax on life insurance company taxable income that is intended to have the same overall revenue consequences as reforms that were proposed in these three areas in the introduced version of the bill. The surtax is intended only as placeholder and the Committee intends to develop reforms in these three areas as the bill moves through the legislative process.

EXPLANATION OF PROVISION

The provision imposes an additional eight-percent income tax on life insurance company taxable income.

EFFECTIVE DATE

The placeholder provision is intended to apply to taxable years beginning after December 31, 2017.

4. Adjustment for change in computing reserves (sec. 3704 of the bill and sec. 807 of the Code)

PRESENT LAW

Change in method of accounting

In general, a taxpayer may change its method of accounting under section 446 with the consent of the Secretary (or may be required to change its method of accounting by the Secretary). In such instances, a taxpayer generally is required to make an adjustment (a "section 481(a) adjustment") to prevent amounts from being duplicated in, or omitted from, the calculation of the taxpayer's income. Pursuant to IRS procedures, negative section 481(a) adjustments generally are deducted from income in the year of the change whereas positive section 481(a) adjustments generally are required to be included in income ratably over four taxable years.[686]

However, section 807(f) explicitly provides that changes in the basis for determining life insurance company reserves are to be taken into account ratably over 10 years.

10-year spread for change in computing life insurance company reserves

For Federal income tax purposes, a life insurance company includes in gross income any net decrease in reserves, and deducts

[686] See, *e.g.*, Rev. Proc. 2015–13, 2015–5 I.R.B. 419, and Rev. Proc. 2017–30, 2017–18 I.R.B. 1131.

a net increase in reserves.[687] Methods for determining reserves for tax purposes generally are based on reserves prescribed by the National Association of Insurance Commissioners for purposes of financial reporting under State regulatory rules.

Income or loss resulting from a change in the method of computing reserves is taken into account ratably over a 10-year period.[688] The rule for a change in basis in computing reserves applies only if there is a change in basis in computing the Federally prescribed reserve (as distinguished from the net surrender value). Although life insurance tax reserves require the use of a Federally prescribed method, interest rate, and mortality or morbidity table, changes in other assumptions for computing statutory reserves (e.g., when premiums are collected and claims are paid) may cause increases or decreases in a company's life insurance reserves that must be spread over a 10-year period. Changes in the net surrender value of a contract are not subject to the 10-year spread because, apart from its use as a minimum in determining the amount of life insurance tax reserves, the net surrender value is not a reserve but a current liability.

If for any taxable year the taxpayer is not a life insurance company, the balance of any adjustments to reserves is taken into account for the preceding taxable year.

REASONS FOR CHANGE

The Committee believes that the treatment of changes to the method of computing reserves of life insurance companies should not differ from the treatment of changes to the method of accounting in the case of other corporations. Consequently, the Committee bill eliminates the separate rule providing a 10-year period for taking into account a change in the method of computing reserves of a life insurer.

EXPLANATION OF PROVISION

Income or loss resulting from a change in method of computing life insurance company reserves is taken into account consistent with IRS procedures, generally ratably over a four-year period, instead of over a 10-year period.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

5. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account (sec. 3705 of the bill and sec. 815 of the Code)

PRESENT AND PRIOR LAW

Under the law in effect from 1959 through 1983, a life insurance company was subject to a three-phase taxable income computation under Federal tax law. Under the three-phase system, a company was taxed on the lesser of its gain from operations or its taxable investment income (Phase I) and, if its gain from operations ex-

[687] Sec. 807.
[688] Sec. 807(f).

ceeded its taxable investment income, 50 percent of such excess (Phase II). Federal income tax on the other 50 percent of the gain from operations was deferred, and was accounted for as part of a policyholder's surplus account and, subject to certain limitations, taxed only when distributed to stockholders or upon corporate dissolution (Phase III). To determine whether amounts had been distributed, a company maintained a shareholders surplus account, which generally included the company's previously taxed income that would be available for distribution to shareholders. Distributions to shareholders were treated as being first out of the shareholders surplus account, then out of the policyholders surplus account, and finally out of other accounts.

The Deficit Reduction Act of 1984[689] included provisions that, for 1984 and later years, eliminated further deferral of tax on amounts (described above) that previously would have been deferred under the three-phase system. Although for taxable years after 1983, life insurance companies may not enlarge their policyholders surplus account, the companies are not taxed on previously deferred amounts unless the amounts are treated as distributed to shareholders or subtracted from the policyholders surplus account.[690]

Any direct or indirect distribution to shareholders from an existing policyholders surplus account of a stock life insurance company is subject to tax at the corporate rate in the taxable year of the distribution. Present law (like prior law) provides that any distribution to shareholders is treated as made (1) first out of the shareholders surplus account, to the extent thereof, (2) then out of the policyholders surplus account, to the extent thereof, and (3) finally, out of other accounts.

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

REASONS FOR CHANGE

The Committee believes it is appropriate to require life insurers with a policyholders surplus account to be subject to current income taxation on any remaining amounts of income deferred from periods before 1984.

EXPLANATION OF PROVISION

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

In the case of any stock life insurance company with an existing policyholders surplus account (as defined in section 815 before its repeal), tax is imposed on the balance of the account as of December 31, 2017. A life insurance company is required to pay tax on the balance of the account ratably over the first eight taxable years beginning after December 31, 2017.

[689] Pub. L. No. 98–369.
[690] Sec. 815.

Specifically, the tax imposed on a life insurance company is the tax on the sum of life insurance company taxable income for the taxable year (but not less than zero) plus 1/8 of the balance of the existing policyholders surplus account as of December 31, 2017. Thus, life insurance company losses are not allowed to offset the amount of the policyholders surplus account balance subject to tax.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

6. Modification of proration rules for property and casualty insurance companies (sec. 3706 of the bill and sec. 832 of the Code)

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

A proration rule applies to property and casualty insurance companies. In calculating the deductible amount of its reserve for losses incurred, a property and casualty insurance company must reduce the amount of losses incurred by 15 percent of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment, or annuity contracts the company owns.[691] This proration rule reflects the fact that reserves are generally funded in part from tax-exempt interest, from deductible dividends, and from other untaxed amounts.

REASONS FOR CHANGE

The Committee believes that the rate of proration applicable to property and casualty insurers with respect to untaxed income should be adjusted to take account of the tax rate reduction to 20 percent that applies to income of corporations, including property and casualty insurers. The Committee bill therefore modifies the percentage applicable under the proration rule.

EXPLANATION OF PROVISION

The provision replaces the 15-percent reduction under present law with a 26.25-percent reduction under the proration rule for property and casualty insurance companies. This change in the percentage takes into account the reduction in the corporate tax rate from 35 to 20 percent under section 3001 of the bill (reduction in corporate tax rate).

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

[691] Sec. 832(b)(5).

7. Modification of discounting rules for property and casualty insurance companies (sec. 3707 of the bill and sec. 832 of the Code)

PRESENT LAW

A property and casualty insurance company generally is subject to tax on its taxable income.[692] The taxable income of a property and casualty insurance company is determined as the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions.[693] Among the items that are deductible in calculating underwriting income are additions to reserves for losses incurred and expenses incurred.

To take account of the time value of money, discounting of unpaid losses is required. All property and casualty loss reserves (unpaid losses and unpaid loss adjustment expenses) for each line of business (as shown on the annual statement) are required to be discounted for Federal income tax purposes.

The discounted reserves are calculated using a prescribed interest rate which is based on the applicable Federal mid-term rate ("mid-term AFR"). The discount rate is the average of the mid-term AFRs effective at the beginning of each month over the 60-month period preceding the calendar year for which the determination is made.

To determine the period over which the reserves are discounted, a prescribed loss payment pattern applies. The prescribed length of time is either the accident year and the following three calendar years, or the accident year and the following 10 calendar years, depending on the line of business. In the case of certain "long-tail" lines of business, the 10-year period is extended, but not by more than five additional years. Thus, present law limits the maximum duration of any loss payment pattern to the accident year and the following 15 years. The Treasury Department is directed to determine a loss payment pattern for each line of business by reference to the historical loss payment pattern for that line of business using aggregate experience reported on the annual statements of insurance companies, and is required to make this determination every five years, starting with 1987.

Under the discounting rules, an election is provided permitting a taxpayer to use its own (rather than an industry-wide) historical loss payment pattern with respect to all lines of business, provided that applicable requirements are met.

Treasury publishes discount factors for each line of business to be applied by taxpayers for discounting reserves.[694] The discount factors are published annually, based on (1) the interest rate applicable to the calendar year, and (2) the loss payment pattern for each line of business as determined every five years.

REASONS FOR CHANGE

The Committee believes that the loss payment patterns prescribed by present law for property and casualty insurers do not accurately reflect the duration of these liabilities and should be extended. To ensure that the length of the period is reasonable from

[692] Sec. 831(a).
[693] Sec. 832.
[694] The most recent property and casualty reserve discount factors published by Treasury are in Rev. Proc. 2016–58, 2016–51 I.R.B. 839, and see Rev. Proc. 2012–44, 2012–49 I.R.B. 645.

a record-keeping perspective, the period is not indefinite, but rather, is limited to 18 years after the accident year, or 25 years after the accident year for long-tail lines of business. In the interests of neutrality of the tax law across taxpayers, the Committee bill repeals the election of a property and casualty insurer to use its own loss payment pattern rather than an industry loss payment pattern for purposes of the loss reserve discounting rules. The Committee believes that the interest rate applicable today for purposes of the loss reserve discounting rules does not accurately take account of the time value of money. In order to more accurately measure income, the rate should be based on a rate more closely related to property and casualty companies' yield on assets. Therefore, the Committee bill provides for an interest rate based on the corporate bond yield curve.

EXPLANATION OF PROVISION

The provision modifies the reserve discounting rules applicable to property and casualty insurance companies. In general, the provision modifies the prescribed interest rate, extends the periods applicable under the loss payment pattern, and repeals the election to use a taxpayer's historical loss payment pattern.

Interest rate

The provision provides that the interest rate is an annual rate for any calendar year to be determined by Treasury based on the corporate bond yield curve (rather than the mid-term AFR as under present law). For this purpose, the corporate bond yield curve means, with respect to any month, a yield curve that reflects the average, for the preceding 24-month period, of monthly yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available.[695] Because the corporate bond yield curve provides for 24-month averaging, the present-law rule providing for 60-month averaging to determine the interest rate is repealed under the provision. It is expected that Treasury will determine a 24-month average for the 24 months preceding the first month of the calendar year for which the determination is made.

Loss payment patterns

The provision extends the periods applicable for determining loss payment patterns. Under the provision, the maximum duration of the loss payment pattern is determined by the amount of losses remaining unpaid using aggregate industry experience for each line of business, rather than by a set number of years as under present law.

Like present law, the provision provides that Treasury determines a loss payment pattern for each line of business by reference to the historical loss payment pattern for that line of business using aggregate experience reported on the annual statements of

[695] This rule adopts the definition found in section 430(h)(2)(D)(i) of the term "corporate bond yield curve." Section 430, which relates to minimum funding standards for single-employer defined benefit pension plans, includes other rules for determining an "effective interest rate," such as segment rate rules. The term "effective interest rate" along with these other rules, including the segment rate rules, do not apply for purposes of property and casualty insurance reserve discounting.

insurance companies, and is required to make this determination every five years.

Under the provision, the present-law three-year and 10-year periods following the accident year are extended up to a maximum of 15 more years for the lines of business to which each period applies. For lines of business to which the three-year period applies, the amount of losses that would have been treated as paid in the third year after the accident year is treated as paid in that year and each subsequent year in an amount equal to the average of the amounts treated as paid in the first and second years (or, if less, the remaining amount). To the extent these unpaid losses have not been treated as paid before the 18th year after the accident year, they are treated as paid in that 18th year.

Similarly, for lines of business to which the 10-year period applies, the amount of losses that would have been treated as paid in the 10th year following the accident year is treated as paid in that year and each subsequent year in an amount equal to the average of the amounts treated as paid in the seventh, eighth, and ninth years (or if less, the remaining amount). To the extent these unpaid losses have not been treated as paid before the 25th year after the accident year, they are treated as paid in that 25th year.

The provision repeals the present-law rule providing that in the case of certain "long-tail" lines of business, the 10-year period is extended, but not by more than five additional years. The provision does not change the lines of business to which the three-year, and 10-year, periods, respectively, apply.

Election to use own historical loss payment pattern

The provision repeals the present-law election permitting a taxpayer to use its own (rather than an aggregate industry-experience-based) historical loss payment pattern with respect to all lines of business.

EFFECTIVE DATE

The provision generally applies to taxable years beginning after December 31, 2017. Under a transitional rule for the first taxable year beginning in 2018, the amount of unpaid losses and expenses unpaid (under section 832(b)(5)(B) and (6)) and the unpaid losses (under sections 807(c)(2) and 805(a)(1)) at the end of the preceding taxable year are determined as if the provision had applied to these items in such preceding taxable year, using the interest rate and loss payment patterns for accident years ending with calendar year 2018. Any adjustment is spread over eight taxable years, *i.e.*, is included in the taxpayer's gross income ratably in the first taxable year beginning in 2018 and the seven succeeding taxable years. For taxable years subsequent to the first taxable year beginning in 2018, the provision applies to such unpaid losses and expenses unpaid (*i.e.*, unpaid losses and expenses unpaid at the end of the taxable year preceding the first taxable year beginning in 2018) by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018.

8. Repeal of special estimated tax payments (sec. 3708 of the bill and sec. 847 of the Code)

PRESENT LAW

Allowance of additional deduction and establishment of special loss discount account

Present law allows an insurance company required to discount its reserves an additional deduction that is not to exceed the excess of (1) the amount of the undiscounted unpaid losses over (2) the amount of the related discounted unpaid losses, to the extent the amount was not deducted in a preceding taxable year.[696] The provision imposes the requirement that a special loss discount account be established and maintained, and that special estimated tax payments be made. Unused amounts of special estimated tax payments are treated as a section 6655 estimated tax payment for the 16th year after the year for which the special estimated tax payment was made.

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

Calculation of special estimated tax payments based on tax benefit attributable to deduction

More specifically, present law imposes a requirement that the taxpayer make special estimated tax payments in an amount equal to the tax benefit attributable to the additional deduction allowed under the provision. If amounts are included in gross income as a result of a reduction in the taxpayer's special loss discount account or the liquidation or termination of the taxpayer's insurance business, and an additional tax is due for any year as a result of the inclusion, then an amount of the special estimated tax payments equal to such additional tax is applied against such additional tax. If there is an adjustment reducing the amount of additional tax against which the special estimated tax payment was applied, then in lieu of any credit or refund for the reduction, a special estimated tax payment is treated as made in an amount equal to the amount that would otherwise be allowable as a credit or refund.

The amount of the tax benefit attributable to the deduction is to be determined (under Treasury regulations (which have not been promulgated)) by taking into account tax benefits that would arise from the carryback of any net operating loss for the year as well as current year benefits. In addition, tax benefits for the current and carryback years are to take into account the benefit of filing a consolidated return with another insurance company without regard to the consolidation limitations imposed by section 1503(c).

The taxpayer's estimated tax payments under section 6655 are to be determined without regard to the additional deduction allowed under this provision and the special estimated tax payments. Leg-

[696] Sec. 847.

islative history[697] indicates that it is intended that the taxpayer may apply the amount of an overpayment of any section 6655 estimated tax payments for the taxable year against the amount of the special estimated tax payment required under this provision. The special estimated tax payments under this provision are not treated as estimated tax payments for purposes of section 6655 (e.g., for purposes of calculating penalties or interest on underpayments of estimated tax) when such special estimated tax payments are made.

Refundable amount

To the extent that a special estimated tax payment is not used to offset additional tax due for any of the first 15 taxable years beginning after the year for which the payment was made, such special estimated tax payment is treated as an estimated tax payment made under section 6655 for the 16th year after the year for which the special estimated tax payment was made. If the amount of such deemed section 6655 payment, together with the taxpayer's other payments credited against tax liability for such 16th year, exceeds the tax liability for such year, then the excess (up to the amount of the deemed section 6655 payment) may be refunded to the taxpayer to the same extent provided under present law with respect to overpayments of tax.

Regulatory authority

In addition to the regulatory authority to adjust the amount of special estimated tax payments in the event of a change in the corporate tax rate, authority is provided to Treasury to prescribe regulations necessary or appropriate to carry out the purposes of the provision.

Such regulations include those providing for the separate application of the provision with respect to each accident year. Separate application of the provision with respect to each accident year (i.e., applying a vintaging methodology) may be appropriate under regulations to determine the amount of tax liability for any taxable year against which special estimated tax payments are applied, and to determine the amount (if any) of special estimated tax payments remaining after the 15th year which may be available to be refunded to the taxpayer.

Regulatory authority is also provided to make such adjustments in the application of the provision as may be necessary to take into account the corporate alternative minimum tax. Under this regulatory authority, rules similar to those applicable in the case of a change in the corporate tax rate are intended to apply to determine the amount of special estimated tax payments that may be applied against tax calculated at the corporate alternative minimum tax rate. The special estimated tax payments are not treated as payments of regular tax for purposes of determining the taxpayer's alternative minimum tax liability.

Regulations have not been promulgated under section 847.

[697] See H.R. Rep. No. 100–1104, Conference Report to accompany H.R. 4333, the Technical and Miscellaneous Revenue Act of 1988, October 21, 1988, p. 174.

REASONS FOR CHANGE

The Committee believes that the special estimated tax payment rules add complexity to the tax law and do not improve the accuracy of income measurement of property and casualty insurers. The Committee bill therefore repeals these rules.

EXPLANATION OF PROVISION

The provision repeals section 847. Thus, the election to apply section 847, the additional deduction, special loss discount account, special estimated tax payment, and refundable amount rules of present law are eliminated.

The entire balance of an existing account is included in income of the taxpayer for the first taxable year beginning after 2017, and the entire amount of existing special estimated tax payments are applied against the amount of additional tax attributable to this inclusion. Any special estimated tax payments in excess of this amount are treated as estimated tax payments under section 6655.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

I. COMPENSATION

1. Modification of limitation on excessive employee remuneration (sec. 3801 of the bill and sec. 162(m) of the Code)

PRESENT LAW

In general

An employer generally may deduct reasonable compensation for personal services as an ordinary and necessary business expense. Section 162(m) provides an explicit limitation on the deductibility of compensation expenses in the case of publicly traded corporate employers. The otherwise allowable deduction for compensation with respect to a covered employee of a publicly held corporation[698] is limited to no more than $1 million per year.[699] The deduction limitation applies when the deduction attributable to the compensation would otherwise be taken.

Covered employees

Section 162(m) defines a covered employee as (1) the chief executive officer of the corporation (or an individual acting in such capacity) as of the close of the taxable year and (2) any employee whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934 ("Exchange Act") by reason of being among the corporation's four most highly compensated officers for the taxable year (other than the chief executive officer).[700] Treasury regulations under section 162(m) provide that

[698] A corporation is treated as publicly held if it has a class of common equity securities that is required to be registered under section 12 of the Securities Exchange Act of 1934. Section 162(m)(2).

[699] Sec. 162(m). This deduction limitation applies for purposes of the regular income tax and the alternative minimum tax.

[700] Sec. 162(m)(3).

whether an employee is the chief executive officer or among the four most highly compensated officers should be determined pursuant to the executive compensation disclosure rules promulgated under the Exchange Act.

In 2006, the Securities and Exchange Commission amended certain rules relating to executive compensation, including which officers' compensation must be disclosed under the Exchange Act. Under the new rules, such officers are (1) the principal executive officer (or an individual acting in such capacity), (2) the principal financial officer (or an individual acting in such capacity), and (3) the three most highly compensated officers, other than the principal executive officer or principal financial officer.

In response to the Securities and Exchange Commission's new disclosure rules, the Internal Revenue Service issued updated guidance on identifying which employees are covered by section 162(m).[701] The new guidance provides that "covered employee" means any employee who is (1) as of the close of the taxable year, the principal executive officer (or an individual acting in such capacity) defined in reference to the Exchange Act, or (2) among the three most highly compensated officers[702] for the taxable year (other than the principal executive officer or principal financial officer), again defined by reference to the Exchange Act. Thus, under current guidance, only four employees are covered under section 162(m) for any taxable year. Under Treasury regulations, the requirement that the individual meet the criteria as of the last day of the taxable year applies to both the principal executive officer and the three highest compensated officers.[703]

Definition of publicly held corporation

For purposes of the deduction disallowance of section 162(m), a publicly held corporation means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934.[704] All U.S. publicly traded companies are subject to this registration requirement, including their foreign affiliates. A foreign company publicly traded through American depository receipts ("ADRs") is also subject to this registration requirement if more than 50 percent of the issuer's outstanding voting securities are held, directly or indirectly, by residents of United States and either (i) the majority of the executive officers or directors are United States citizens or residents, (ii) more than 50 percent of the assets of the issuer are located in the United States, or (iii) the business of the issuer is administered principally in the United States. Other foreign companies are not subject to the registration requirement.

Remuneration subject to the deduction limitation

In general

Unless specifically excluded, the deduction limitation applies to all remuneration for services, including cash and the cash value of all remuneration (including benefits) paid in a medium other than

[701] Notice 2007–49, 2007–25 I.R.B. 1429.
[702] By reason of being among the officers whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.
[703] Treas. Reg. sec. 1.162–27(c)(2).
[704] Sec. 162(m)(2).

cash. If an individual is a covered employee for a taxable year, the deduction limitation applies to all compensation not explicitly excluded from the deduction limitation, regardless of whether the compensation is for services as a covered employee and regardless of when the compensation was earned. The $1 million cap is reduced by excess parachute payments (as defined in section 280G) that are not deductible by the corporation.[705]

Certain types of compensation are not subject to the deduction limit and are not taken into account in determining whether other compensation exceeds $1 million. The following types of compensation are not taken into account: (1) remuneration payable on a commission basis;[706] (2) remuneration payable solely on account of the attainment of one or more performance goals if certain outside director and shareholder approval requirements are met ("performance-based compensation");[707] (3) payments to a tax-favored retirement plan (including salary reduction contributions); (4) amounts that are excludable from the executive's gross income (such as employer-provided health benefits and miscellaneous fringe benefits);[708] and (5) any remuneration payable under a written binding contract which was in effect on February 17, 1993. In addition, remuneration does not include compensation for which a deduction is allowable after a covered employee ceases to be a covered employee. Thus, the deduction limitation often does not apply to deferred compensation that is otherwise subject to the deduction limitation (e.g., is not performance-based compensation) because the payment of compensation is deferred until after termination of employment.

Performance-based compensation

Compensation qualifies for the exception for performance-based compensation only if (1) it is paid solely on account of the attainment of one or more performance goals, (2) the performance goals are established by a compensation committee consisting solely of two or more outside directors,[709] (3) the material terms under which the compensation is to be paid, including the performance goals, are disclosed to and approved by the shareholders in a separate majority-approved vote prior to payment, and (4) prior to payment, the compensation committee certifies that the performance goals and any other material terms were in fact satisfied.

Compensation (other than stock options or other stock appreciation rights ("SARs")) is not treated as paid solely on account of the attainment of one or more performance goals unless the compensation is paid to the particular executive pursuant to a pre-established objective performance formula or standard that precludes discretion. A stock option or SAR with an exercise price not less than the fair market value, on the date the option or SAR is granted, of the stock subject to the option or SAR, generally is treated as meeting the exception for performance-based compensation, pro-

[705] Sec. 162(m)(4)(F).
[706] Sec. 162(m)(4)(B).
[707] Sec. 162(m)(4)(C).
[708] Secs. 105, 106, and 132.
[709] A director is considered an outside director if he or she is not a current employee of the corporation (or related entities), is not a former employee of the corporation (or related entities) who is receiving compensation for prior services (other than benefits under a qualified retirement plan), was not an officer of the corporation (or related entities) at any time, and is not currently receiving compensation for personal services in any capacity (e.g., for services as a consultant) other than as a director.

vided that the requirements for outside director and shareholder approval are met (without the need for certification that the performance standards have been met). This is the case because the amount of compensation attributable to the options or SARs received by the executive is based solely on an increase in the corporation's stock price. Stock-based compensation is not treated as performance-based if it depends on factors other than corporate performance.

REASONS FOR CHANGE

The Committee believes that the significant exceptions to the limit on 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. The Committee further believes this shift has led to perverse consequences resulting from the focus of such executives and businesses on quarterly results, rather than the long-term success of the company and its rank-and-file workers. Additionally, the Committee believes that aligning the deductibility limit between domestically traded publicly traded corporations and all foreign companies that trade ADRs in the United States, as well as certain private C corporations and S corporations, promotes fair tax treatment across similarly situated businesses. The Committee believes the law should be clarified to override administrative guidance, Notice 2007–49, 2007–25 I.R.B. 1429, which, contrary to the statute, limits the number of covered employees to four.

EXPLANATION OF PROVISION

Definition of covered employee

The provision revises the definition of covered employee to include both the principal executive officer and the principal financial officer. Further, an individual is a covered employee if the individual holds one of these positions at any time during the taxable year. The provision also defines as a covered employee the three (rather than four) most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer) who are required to be reported on the company's proxy statement (i.e., the statement required pursuant to executive compensation disclosure rules promulgated under the Exchange Act) for the taxable year (or who would be required to be reported on such a statement for a company not required to make such a report to shareholders). This includes such officers of a corporation not required to file a proxy statement but which otherwise falls within the revised definition of a publicly held corporation, as well as such officers of a publicly traded corporation that would otherwise have been required to file a proxy statement for the year (for example, but for the fact that the corporation delisted its securities or underwent a transaction that resulted in the nonapplication of the proxy statement requirement).

In addition, if an individual is a covered employee with respect to a corporation for a taxable year beginning after December 31, 2016, the individual remains a covered employee for all future years. Thus, an individual remains a covered employee with respect to compensation otherwise deductible for subsequent years, including for years during which the individual is no longer employed by the corporation and years after the individual has died. Compensation does not fail to be compensation with respect to a covered employee and thus subject to the deduction limit for a taxable year merely because the compensation is includible in the income of, or paid to, another individual, such as compensation paid to a beneficiary after the employee's death, or to a former spouse pursuant to a domestic relations order.

Definition of publicly held corporation

The provision extends the applicability of section 162(m) to include all domestic publicly traded corporations and all foreign companies publicly traded through ADRs. The proposed definition may include certain additional corporations that are not publicly traded, such as large private C or S corporations.

Performance-based compensation and commissions exceptions

The provision eliminates the exceptions for commissions and performance-based compensation from the definition of compensation subject to the deduction limit. Thus, such compensation is taken into account in determining the amount of compensation with respect to a covered employee for a taxable year that exceeds $1 million and is thus not deductible under section 162.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

2. Excise tax on excess tax-exempt organization executive compensation (sec. 3802 of the bill and sec. 4960 of the Code)

PRESENT LAW

Taxable employers and other service recipients generally may deduct reasonable compensation expenses.[710] However, in some cases, compensation in excess of specific levels is not deductible.

A publicly held corporation generally cannot deduct more than $1 million of compensation (that is not compensation otherwise excepted from this limit) in a taxable year for each "covered employee."[711] For this purpose, a covered employee is the corporation's principal executive officer (or an individual acting in such capacity) defined in reference to the Securities Exchange Act of 1934 ("Exchange Act") as of the close of the taxable year, or any employee whose total compensation is required to be reported to shareholders under the Exchange Act by reason of being among the corporation's three most highly compensated officers for the taxable year (other than the principal executive officer or principal financial officer).[712]

Unless an exception applies, generally a corporation cannot deduct that portion of the aggregate present value of a "parachute payment" which equals or exceeds three times the "base amount" of certain service providers. The nondeductible excess is an "excess

[710] Sec. 162(a)(1).

[711] Sec. 162(m)(1). Under section 162(m)(6), limits apply to deductions for compensation of individuals performing services for certain health insurance providers.

[712] Notice 2007–49, 2007–2 I.R.B. 1429.

parachute payment."[713] A parachute payment is generally a payment of compensation that is contingent on a change in corporate ownership or control made to certain officers, shareholders, and highly compensated individuals.[714] An individual's base amount is the average annualized compensation includible in the individual's gross income for the five taxable years ending before the date on which the change in ownership or control occurs.[715] Certain amounts are not considered parachute payments, including payments under a qualified retirement plan, a simplified employee pension plan, or a simple retirement account.[716]

These deduction limits generally do not affect a tax-exempt organization.

REASONS FOR CHANGE

The Committee believes that tax-exempt organizations enjoy a tax subsidy from the Federal government because contributions to such organizations are generally deductible and such organizations are generally not subject to tax (except on unrelated business income). As a result, such organizations are subject to the requirement that they use their resources for specific purposes, and the Committee believes that excessive compensation (including excessive severance packages) paid to senior executives of such organizations diverts resources from those particular purposes. The Committee further believes that alignment of the tax treatment of excessive executive compensation (as top executives may inappropriately divert organizational resources into excessive compensation) between for-profit and tax-exempt employers furthers the Committee's larger tax reform effort of making the system fairer for all businesses.

EXPLANATION OF PROVISION

Under the provision, an employer is liable for an excise tax equal to 20 percent of the sum of (1) any remuneration (other than an excess parachute payment) in excess of $1 million paid to a covered employee by an applicable tax-exempt organization for a taxable year, and (2) any excess parachute payment (under a new definition for this purpose that relates solely to separation pay) paid by the applicable tax-exempt organization to a covered employee. Accordingly, the excise tax applies as a result of an excess parachute payment, even if the covered employee's remuneration does not exceed $1 million.

For purposes of the provision, a covered employee is an employee (including any former employee) of an applicable tax-exempt organization if the employee is one of the five highest compensated employees of the organization for the taxable year or was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016. An "applicable tax-exempt organization" is an organization exempt from tax under section 501(a), an exempt farmers' cooperative,[717] a Federal, State

[713] Sec. 280G(a) and (b)(1).
[714] Sec. 280G(b)(2) and (c).
[715] Sec. 280G(b)(3).
[716] Secs. 401(a), 403(a), 408(k), and 408(p).
[717] Sec. 521(b).

or local governmental entity with excludable income,[718] or a political organization.[719]

Remuneration means wages as defined for income tax withholding purposes,[720] but does not include any designated Roth contribution.[721] Remuneration of a covered employee includes any remuneration paid with respect to employment of the covered employee by any person or governmental entity related to the applicable tax-exempt organization. A person or governmental entity is treated as related to an applicable tax-exempt organization if the person or governmental entity (1) controls, or is controlled by, the organization, (2) is controlled by one or more persons that control the organization, (3) is a supported organization[722] during the taxable year with respect to the organization, (4) is a supporting organization[723] during the taxable year with respect to the organization, or (5) in the case of a voluntary employees' beneficiary association ("VEBA"),[724] establishes, maintains, or makes contributions to the VEBA. However, remuneration of a covered employee that is not deductible by reason of the $1 million limit on deductible compensation is not taken into account for purposes of the provision.

Under the provision, an excess parachute payment is the amount by which any parachute payment exceeds the portion of the base amount allocated to the payment. A parachute payment is a payment in the nature of compensation to (or for the benefit of) a covered employee if the payment is contingent on the employee's separation from employment and the aggregate present value of all such payments equals or exceeds three times the base amount. The base amount is the average annualized compensation includible in the covered employee's gross income for the five taxable years ending before the date of the employee's separation from employment. Parachute payments do not include payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity,[725] or an eligible deferred compensation plan of a State or local government employer.[726]

The employer of a covered employee is liable for the excise tax. If remuneration of a covered employee from more than one employer is taken into account in determining the excise tax, each employer is liable for the tax in an amount that bears the same ratio to the total tax as the remuneration paid by that employer bears to the remuneration paid by all employers to the covered employee.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

[718] Sec. 115(1).
[719] Sec. 527(e)(1).
[720] Sec. 3401(a).
[721] Under section 402A(c), a designated Roth contribution is an elective deferral (that is, a contribution to a tax-favored employer-sponsored retirement plan made at the election of an employee) that the employee designates as not being excludable from income.
[722] Sec. 509(f)(3). A technical amendment to the provision is needed to reflect the correct statutory citation.
[723] Sec. 509(a)(3).
[724] Sec. 501(c)(9). A technical amendment to the provision is needed to reflect the correct statutory citation.
[725] Sec. 403(b).
[726] Sec. 457(b).

3. Treatment of qualified equity grants (sec. 3803 of the bill and secs. 83, 3401, and 6051 of the Code)

PRESENT LAW

Income tax treatment of employer stock transferred to an employee

Specific rules apply to property, including employer stock, transferred to an employee in connection with the performance of services.[727] These rules govern the amount and timing of income inclusion by the employee and the amount and timing of the employer's compensation deduction.

Under these rules, an employee generally must recognize income in the taxable year in which the employee's right to the stock is transferable or is not subject to a substantial risk of forfeiture, whichever occurs earlier (referred to herein as "substantially vested"). Thus, if the employee's right to the stock is substantially vested when the stock is transferred to the employee, the employee recognizes income in the taxable year of such transfer, in an amount equal to the fair market value of the stock as of the date of transfer (less any amount paid for the stock). If at the time the stock is transferred to the employee, the employee's right to the stock is not substantially vested (referred to herein as "nonvested"), the employee does not recognize income attributable to the stock transfer until the taxable year in which the employee's right becomes substantially vested. In this case, the amount includible in the employee's income is the fair market value of the stock as of the date that the employee's right to the stock is substantially vested (less any amount paid for the stock). However, if the employee's right to the stock is nonvested at the time the stock is transferred to employee, under section 83(b), the employee may elect within 30 days of transfer to recognize income in the taxable year of transfer, referred to as a "section 83(b)" election.[728] If a proper and timely election under section 83(b) is made, the amount of compensatory income is capped at the amount equal to the fair market value of the stock as of the date of transfer (less any amount paid for the stock). A section 83(b) election is available with respect to grants of "restricted stock" (nonvested stock), and does not generally apply to the grant of options.

In general, an employee's right to stock or other property is subject to a substantial risk of forfeiture if the employee's right to full enjoyment of the property is subject to a condition, such as the future performance of substantial services.[729] An employee's right to stock or other property is transferable if the employee can transfer an interest in the property to any person other than the transferor

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[727] Sec. 83. Section 83 applies generally to transfers of any property, not just employer stock, in connection with the performance of services by any service provider, not just an employee. However, the provision described herein applies only with respect to certain employer stock transferred to employees.

[728] Under Treas. Reg. sec. 1.83–2, the employee makes an election by filing with the Internal Revenue Service a written statement that includes the fair market value of the property at the time of transfer and the amount (if any) paid for the property. The employee must also provide a copy of the statement to the employer.

[729] See section 83(c)(1) and Treas. Reg. sec. 1.83–3(c) for the definition of substantial risk of forfeiture.

of the property.[730] Thus, generally, employer stock transferred to an employee by an employer is not transferable merely because the employee can sell it back to the employer.

In the case of stock transferred to an employee, the employer is allowed a deduction (to the extent a deduction for a business expense is otherwise allowable) equal to the amount included in the employee's income as a result of transfer of the stock.[731] The employer deduction generally is permitted in the employer's taxable year in which or with which ends the employee's taxable year when the amount is included and properly reported in the employee's income.[732]

These rules do not apply to the grant of a nonqualified option on employer stock unless the option has a readily ascertainable fair market value.[733] Instead, these rules apply to the transfer of employer stock by the employee on exercise of the option. That is, if the right to the stock is substantially vested on transfer (the time of exercise), income recognition applies for the taxable year of transfer. If the right to the stock is nonvested on transfer, the timing of income inclusion is determined under the rules applicable to the transfer of nonvested stock. In either case, the amount includible in income by the employee is the fair market value of the stock as of the required time of income inclusion, less the exercise price paid by the employee. A section 83(b) election generally does not apply to the grant of options. If upon the exercise of an option, nonvested stock is transferred to the employee, a section 83(b) election may apply. The employer's deduction is generally determined under the rules that apply to transfers of restricted stock, but a special accrual rule may apply under Treasury regulations when the transferred stock is substantially vested.[734]

Employment taxes and reporting

Employment taxes generally consist of taxes under the Federal Insurance Contributions Act ("FICA"), tax under the Federal Unemployment Tax Act ("FUTA"), and income taxes required to be withheld by employers from wages paid to employees ("income tax withholding").[735] Unless an exception applies under the applicable rules, compensation provided to an employee constitutes wages subject to these taxes.

FICA imposes tax on employers and employees, generally based on the amount of wages paid to an employee during the year. Special rules as to the timing and amount of FICA taxes apply in the case of nonqualified deferred compensation, as defined for FICA purposes.[736]

[730] Treas. Reg. sec. 1.83–3(d). In addition, under section 83(c)(2), the right to stock is transferable only if any transferee's right to the stock would not be subject to a substantial risk of forfeiture.

[731] Sec. 83(h).

[732] Treas. Reg. sec. 1.83–6.

[733] See section 83(e)(3) and Treas. Reg. sec. 1.83–7. A nonqualified option is an option on employer stock that is not a statutory option, discussed below.

[734] Treas. Reg. sec. 1.83–6(a)(3).

[735] Secs. 3101–3128 (FICA), 3301–3311 (FUTA), and 3401–3404 (income tax withholding). Instead of FICA taxes, railroad employers and employees are subject, under the Railroad Retirement Tax Act ("RRTA"), sections 3201–3241, to taxes equivalent to FICA taxes with respect to compensation as defined for RRTA purposes. Sections 3501–3510 provide additional rules relating to all these taxes.

[736] Sec. 3121(v); Treas. Reg. sec. 31.3121(v)(2).

The tax imposed on the employer and on the employee is each composed of two parts: (1) the Social Security or old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the OASDI wage base ($127,200 for 2017); and (2) the Medicare or hospital insurance ("HI") tax equal to 1.45 percent of all covered wages.[737] The employee portion of FICA tax generally must be withheld and, along with the employer portion, remitted to the Federal government by the employer. FICA tax withholding applies regardless of whether compensation is provided in the form of cash or a noncash form, such as a transfer of property (including employer stock) or in-kind benefits.[738]

FUTA imposes a tax on employers of six percent of wages up to the FUTA wage base of $7,000.

Income tax withholding generally applies when wages are paid by an employer to an employee, based on graduated withholding rates set out in tables published by the Internal Revenue Service ("IRS").[739] Like FICA tax withholding, income tax withholding applies regardless of whether compensation is provided in the form of cash or a noncash form, such as a transfer of property (including employer stock) or in-kind benefits.

An employer is required to furnish each employee with a statement of compensation information for a calendar year, including taxable compensation, FICA wages, and withheld income and FICA taxes.[740] In addition, information relating to certain nontaxable items must be reported, such as certain retirement and health plan contributions. The statement, made on Form W–2, Wage and Tax Statement, must be provided to each employee by January 31 of the succeeding year.[741]

Statutory options

Two types of statutory options apply with respect to employer stock: incentive stock options ("ISOs") and options provided under an employee stock purchase plan ("ESPP").[742] Stock received pursuant to a statutory option is subject to special rules, rather than the rules for nonqualified options, discussed above. No amount is includible in an employee's income on the grant, vesting, or exercise of a statutory option.[743] In addition, generally no deduction is allowed to the employer with respect to the option or the stock transferred to an employee.

If a holding requirement is met with respect to the stock transferred on exercise of a statutory option and the employee later disposes of the stock, the employee's gain generally is treated as cap-

[737] The employee portion of the HI tax under FICA (not the employer portion) is increased by an additional tax of 0.9 percent on wages received in excess of a threshold amount. The threshold amount is $250,000 in the case of a joint return, $125,000 in the case of a married individual filing a separate return, and $200,000 in any other case.

[738] Under section 3501(b), employment taxes with respect to noncash fringe benefits are to be collected (or paid) by the employer at the time and in the manner prescribed by the Secretary of the Treasury ("Treasury"). Announcement 85–113, 1985–31 I.R.B. 31, provides guidance on the application of employment taxes with respect to noncash fringe benefits.

[739] Sec. 3402. Specific withholding rates apply in the case of supplemental wages.

[740] Secs. 6041 and 6051.

[741] Employers send Form W–2 information to the Social Security Administration, which records information relating to Social Security and Medicare and forwards the Form W–2 information to the IRS. Employees include a copy of Form W–2 with their income tax returns.

[742] Sections 421–424 govern statutory options. Section 423(b)(5) requires that, under the terms of an ESPP, all employees granted options generally must have the same rights and privileges.

[743] Under section 56(b)(3), this income tax treatment with respect to stock received on exercise of an ISO does not apply for purposes of the alternative minimum tax under section 55.

ital gain rather than ordinary income. Under the holding requirement, the employee must not dispose of the stock within two years after the date the option is granted and also must not dispose of the stock within one year after the date the option is exercised. If a disposition occurs before the end of the required holding period (a "disqualifying disposition"), the employee recognizes ordinary income in the taxable year in which the disqualifying disposition occurs and the employer may be allowed a corresponding deduction in the taxable year in which such disposition occurs. The amount of ordinary income recognized when a disqualifying disposition occurs generally equals the fair market value of the stock on the date of exercise (that is, when the stock was transferred to the employee) less the exercise price paid.

Employment taxes do not apply with respect to the grant or vesting of a statutory option, transfer of stock pursuant to the option, or a disposition (including a disqualifying disposition) of the stock.[744] However, certain special reporting requirements apply.

Nonqualified deferred compensation

Compensation is generally includible in an employee's income when paid to the employee. However, in the case of a nonqualified deferred compensation plan,[745] unless the arrangement either is exempt from or meets the requirements of section 409A, the amount of deferred compensation is first includible in income for the taxable year when not subject to a substantial risk of forfeiture (as defined),[746] even if payment will not occur until a later year.[747] In general, to meet the requirements of section 409A, the time when nonqualified deferred compensation will be paid, as well as the amount, must be specified at the time of deferral with limits on further deferral after the time for payment. Various other requirements apply, including that payment can only occur on specific defined events.

Various exemptions from section 409A apply, including transfers of property subject to section 83.[748] Nonqualified options are not automatically exempt from section 409A, but may be structured so as not to be considered nonqualified deferred compensation.[749] A restricted stock unit ("RSU") is a term used for an arrangement under which an employee has the right to receive at a specified time in the future an amount determined by reference to the value of one or more shares of employer stock. An employee's right to receive the future amount may be subject to a condition, such as continued employment for a certain period or the attainment of certain performance goals. The payment to the employee of the amount

[744] Secs. 3121(a)(22), 3306(b)(19), and the last sentence of section 421(b).

[745] Compensation earned by an employee is generally paid to the employee shortly after being earned. However, in some cases, payment is deferred to a later period, referred to as "deferred compensation." Deferred compensation may be provided through a plan that receives tax-favored treatment, such as a qualified retirement plan under section 401(a). Deferred compensation provided through a plan that is not eligible for tax-favored treatment is referred to as "nonqualified" deferred compensation.

[746] Treas. Reg. sec. 1.409A–1(d).

[747] Section 409A and the regulations thereunder provide rules for nonqualified deferred compensation. Compensation that fails to meet the requirements of section 409A is also subject to an additional income tax of 20% on amounts includible in income, and, along with a potential interest factor tax, applies to increases in the value of the failed compensation each year until it is paid.

[748] Treas. Reg. sec. 1.409A–1(b)(6).

[749] Treas. Reg. sec. 1.409A–1(b)(5). In addition, statutory option arrangements are not nonqualified deferred compensation arrangements.

due under the arrangement is referred to as settlement of the RSU. The arrangement may provide for the settlement amount to be paid in cash or as a transfer of employer stock (or either). An arrangement providing RSUs is generally considered a nonqualified deferred compensation plan and is subject to the rules, including the limits, of section 409A. The employer deduction generally is permitted in the employer's taxable year in which or with which ends the employee's taxable year when the amount is included and properly reported in the employee's income.[750]

REASONS FOR CHANGE

Employer stock may provide a valuable form of employee compensation. In some cases, the transfer of employer stock with a high fair market value may result in compensation income, and a related tax liability, that is disproportionately large in comparison to an employee's regular salary or wages. In the case of publicly traded employer stock, an employee may sell some of the stock to provide funds to cover that tax liability. However, that approach often is not available in the case of a closely held company that restricts the transferability of its stock. This may make employer stock a less attractive form of compensation. In the case of stock options, the inability to pay the tax liability that would result from the stock received on exercise of the option may mean employees let options lapse, thus losing compensation they have already earned. The Committee wishes to address these situations by allowing employees to elect to defer recognition of income attributable to stock received on exercise of an option or settlement of an RSU until an opportunity to sell some of the stock arises, but in no event longer than five years from the date that the employee's right to the stock becomes substantially vested.

EXPLANATION OF PROVISION

In general

The provision allows a qualified employee to elect to defer, for income tax purposes, the inclusion in income of the amount of income attributable to qualified stock transferred to the employee by the employer. An election to defer income inclusion ("inclusion deferral election") with respect to qualified stock must be made no later than 30 days after the first time the employee's right to the stock is substantially vested or is transferable, whichever occurs earlier.

If an employee elects to defer income inclusion under the provision, the income must be included in the employee's income for the taxable year that includes the earliest of (1) the first date the qualified stock becomes transferable, including, solely for this purpose, transferable to the employer;[751] (2) the date the employee first becomes an excluded employee (as described below); (3) the first date on which any stock of the employer becomes readily tradable on an established securities market;[752] (4) the date five

[750] Sec. 404(a)(5).
[751] Thus, for this purpose, the qualified stock is considered transferable if the employee has the ability to sell the stock to the employer (or any other person).
[752] An established securities market is determined for this purpose by the Secretary, but does not include any market unless the market is recognized as an established securities market for purposes of another Code provision.

years after the first date the employee's right to the stock becomes substantially vested; or (5) the date on which the employee revokes her inclusion deferral election.[753]

An inclusion deferral election is made in a manner similar to the manner in which a section 83(b) election is made.[754] The provision does not apply to income with respect to nonvested stock that is includible as a result of a section 83(b) election. The provision clarifies that Section 83 (other than the provision), including subsection (b), shall not apply to RSUs. Therefore, RSUs are not eligible for a section 83(b) election. This is the case because, absent this provision, RSUs are nonqualified deferred compensation and therefore subject to the rules that apply to nonqualified deferred compensation.

An employee may not make an inclusion deferral election for a year with respect to qualified stock if, in the preceding calendar year, the corporation purchased any of its outstanding stock unless at least 25 percent of the total dollar amount of the stock so purchased is stock with respect to which an inclusion deferral election is in effect ("deferral stock") and the determination of which individuals from whom deferral stock is purchased is made on a reasonable basis.[755] For purposes of this requirement, stock purchased from an individual is not treated as deferral stock (and the purchase is not treated as a purchase of deferral stock) if, immediately after the purchase, the individual holds any deferral stock with respect to which an inclusion deferral election has been in effect for a longer period than the election with respect to the purchased stock. Thus, in general, in applying the purchase requirement, an individual's deferral stock with respect to which an inclusion deferral election has been in effect for the longest periods must be purchased first. A corporation that has deferral stock outstanding as of the beginning of any calendar year and that purchases any of its outstanding stock during the calendar year must report on its income tax return for the taxable year in which, or with which, the calendar year ends the total dollar amount of the outstanding stock purchased during the calendar year and such other information as the Secretary may require for purposes of administering this requirement.

A qualified employee may make an inclusion deferral election with respect to qualified stock attributable to a statutory option.[756] In that case, the option is not treated as a statutory option and the rules relating to statutory options and related stock do not apply. In addition, an arrangement under which an employee may receive qualified stock is not treated as a nonqualified deferred compensation plan solely because of an employee's inclusion deferral election or ability to make an election.

Deferred income inclusion applies also for purposes of the employer's deduction of the amount of income attributable to the qualified stock. That is, if an employee makes an inclusion deferral

[753] An inclusion deferral election is revoked at the time and in the manner as the Secretary provides.

[754] Thus, as in the case of a section 83(b) election under present law, the employee must provide a copy of the inclusion deferral election to the employer.

[755] This requirement is met if the stock purchased by the corporation includes all the corporation's outstanding deferral stock.

[756] For purposes of the requirement that an ESPP provide employees with the same rights and privileges, the rules of the provision apply in determining which employees have the right to make an inclusion deferral election with respect to stock received under the ESPP.

election, the employer's deduction is deferred until the employer's taxable year in which or with which ends the taxable year of the employee for which the amount is included in the employee's income as described in (1)–(5) above.

Qualified employee and qualified stock

Under the provision, a qualified employee means an individual who is not an excluded employee and who agrees, in the inclusion deferral election, to meet the requirements necessary (as determined by the Secretary) to ensure the income tax withholding requirements of the employer corporation with respect to the qualified stock (as described below) are met. For this purpose, an excluded employee with respect to a corporation is any individual (1) who was a one-percent owner of the corporation at any time during the 10 preceding calendar years,[757] (2) who is, or has been at any prior time, the chief executive officer or chief financial officer of the corporation or an individual acting in either capacity, (3) who is a family member of an individual described in (1) or (2),[758] or (4) who has been one of the four highest compensated officers of the corporation for any of the 10 preceding taxable years.[759]

Qualified stock is any stock of a corporation if—

- an employee receives the stock in connection with the exercise of an option or in settlement of an RSU, and
- the option or RSU was granted by the corporation to the employee in connection with the performance of services and in a year in which the corporation was an eligible corporation (as described below).

However, qualified stock does not include any stock if, at the time the employee's right to the stock becomes substantially vested, the employee may sell the stock to, or otherwise receive cash in lieu of stock from, the corporation. Qualified stock can only be such if it relates to stock received in connection with options or RSUs, and does not include stock received in connection with other forms of equity compensation, including stock appreciation rights or restricted stock.

A corporation is an eligible corporation with respect to a calendar year if (1) no stock of the employer corporation (or any predecessor) is readily tradable on an established securities market during any preceding calendar year,[760] and (2) the corporation has a written plan under which, in the calendar year, not less than 80 percent of all employees who provide services to the corporation in the United States (or any U.S. possession) are granted stock options, or restricted stock units ("RSUs"), with the same rights and privileges to receive qualified stock ("80-percent requirement").[761] For

[757] One-percent owner status is determined under the top-heavy rules for qualified retirement plans, that is, section 416(i)(1)(B)(ii).

[758] In the case of one-percent owners, this results from application of the attribution rules of section 318 under section 416(i)(1)(B)(i)(II). Family members are determined under section 318(a)(1) and generally include an individual's spouse, children, grandchildren and parents.

[759] These officers are determined on the basis of shareholder disclosure rules for compensation under the Securities Exchange Act of 1934, as if such rules applied to the corporation.

[760] This requirement continues to apply up to the time an inclusion deferral election is made. That is, under the provision, no inclusion deferral election may be made with respect to qualified stock if any stock of the corporation is readily tradable on an established securities market at any time before the election is made.

[761] In applying the requirement that 80 percent of employees receive stock options or RSUs, excluded employees and part-time employees are not taken into account. For this purpose, part-

Continued

this purpose, in general, the determination of rights and privileges with respect to stock is determined in a similar manner as provided under the present-law ESPP rules.[762] However, employees will not fail to be treated as having the same rights and privileges to receive qualified stock solely because the number of shares available to all employees is not equal in amount, provided that the number of shares available to each employee is more than a de minimis amount. In addition, rights and privileges with respect to the exercise of a stock option are not treated for this purpose as the same as rights and privileges with respect to the settlement of an RSU.[763]

For purposes of the provision, corporations that are members of the same controlled group[764] are treated as one corporation.

Notice, withholding and reporting requirements

Under the provision, a corporation that transfers qualified stock to a qualified employee must provide a notice to the qualified employee at the time (or a reasonable period before) the employee's right to the qualified stock is substantially vested (and income attributable to the stock would first be includible absent an inclusion deferral election). The notice must (1) certify to the employee that the stock is qualified stock, and (2) notify the employee (a) that the employee may (if eligible) elect to defer income inclusion with respect to the stock and (b) that, if the employee makes an inclusion deferral election, the amount of income required to be included at the end of the deferral period will be based on the value of the stock at the time the employee's right to the stock first becomes substantially vested, notwithstanding whether the value of the stock has declined during the deferral period (including whether the value of the stock has declined below the employee's tax liability with respect to such stock), and the amount of income to be included at the end of the deferral period will be subject to withholding as provided under the provision, as well as of the employee's responsibilities with respect to required withholding. Failure to provide the notice may result in the imposition of a penalty of $100 for each failure, subject to a maximum penalty of $50,000 for all failures during any calendar year.

An inclusion deferral election applies only for income tax purposes. The application of FICA and FUTA are not affected. The provision includes specific income tax withholding and reporting requirements with respect to income subject to an inclusion deferral election.

For the taxable year for which income subject to an inclusion deferral election is required to be included in income by the employee (as described above), the amount required to be included in income is treated as wages with respect to which the employer is required to withhold income tax at a rate not less than the highest income

time employee is defined under section 4980G(d)(4), as an employee who is customarily employed for fewer than 30 hours per week. (A technical amendment to the provision is needed to reflect the correct statutory citation defining part-time employees.)

[762] Sec. 423(b)(5).

[763] Under a transition rule, in the case of a calendar year beginning before January 1, 2018, the 80-percent requirement is applied without regard to whether the rights and privileges with respect to the qualified stock are the same.

[764] As defined in sec. 1563(a).

tax rate applicable to individual taxpayers.[765] The employer must report on Form W–2 the amount of income covered by an inclusion deferral election (1) for the year of deferral and (2) for the year the income is required to be included in income by the employee. In addition, for any calendar year, the employer must report on Form W–2 the aggregate amount of income covered by inclusion deferral elections, determined as of the close of the calendar year.

EFFECTIVE DATE

The provision generally applies with respect to stock attributable to options exercised or RSUs settled after December 31, 2017. Under a transition rule, until the Secretary (or the Secretary's delegate) issues regulations or other guidance implementing the 80-percent and employer notice requirements under the provision, a corporation will be treated as complying with those requirements (respectively) if it complies with a reasonable good faith interpretation of the requirements. The penalty for a failure to provide the notice required under the provision applies to failures after December 31, 2017.

TITLE IV—TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS

PRESENT LAW

The following discussion of present law provides an overview of general principles of taxation of cross-border activity as well as a detailed explanation of provisions in present law that are relevant to the provisions included in Title IV of the bill as reported out of Committee.

Present law combines taxation of all U.S. persons on their worldwide income, whether derived in the United States or abroad, with limited deferral of taxation of income earned by foreign subsidiaries of U.S. companies and source-based taxation of the U.S.-source income of nonresident aliens and foreign entities. Under this system (sometimes described as the U.S. hybrid system), the application of the Code differs depending on whether income arises from outbound investment or inbound investment. Outbound investment refers to the foreign activities of U.S. persons, while inbound investment is investment by foreign persons in U.S. assets or activities, although certain rules are common to both inbound and outbound activities.

A. Principles Common to Inbound and Outbound Taxation

Although the U.S. tax rules differ depending on whether the activity in question is inbound or outbound, there are certain concepts that apply to both inbound and outbound investment. Such areas include the transfer pricing rules, entity classification, the rules for determination of source, and whether a corporation is foreign or domestic.

[765] That is, the maximum rate of tax in effect for the year under section 1. The provision specifies that qualified stock is treated as a noncash fringe benefit for income tax withholding purposes.

1. Residence

U.S. persons are subject to tax on their worldwide income. The Code defines U.S. person to include all U.S. citizens and residents as well as domestic entities such as partnerships, corporations, estates and certain trusts.[766] The term "resident" is defined only with respect to natural persons. Noncitizens who are lawfully admitted as permanent residents of the United States in accordance with immigration laws (colloquially referred to as green card holders) are treated as residents for tax purposes. In addition, noncitizens who meet a substantial presence test and are not otherwise exempt from U.S. taxation are also taxable as U.S. residents.[767]

For legal entities, the Code determines whether an entity is subject to U.S. taxation on its worldwide income on the basis of its place of organization. For purposes of U.S. tax law, a corporation or partnership is treated as domestic if it is organized or created under the laws of the United States or of any State, unless, in the case of a partnership, the Secretary prescribes otherwise by regulation.[768] Other partnerships and corporations (that is, those organized under the laws of foreign countries) are generally treated as foreign.[769] In contrast, place of organization is not determinative of residence under taxing jurisdictions that use factors such as situs, management and control to determine residence. As a result, legal entities may have more than one tax residence, or, in some case, no residence.[770] Only domestic corporations are subject to U.S. tax on a worldwide basis. Foreign corporations are taxed only on income that has a sufficient connection with the United States.

Tax benefits otherwise available to a domestic corporation that migrates its tax home from the United States to foreign jurisdiction may be denied to such corporation for ten years following such migration.[771] These sanctions generally apply to a transaction in which, pursuant to a plan or a series of related transactions: (1) a domestic corporation becomes a subsidiary of a foreign-incorporated entity or otherwise transfers substantially all of its properties to such an entity in a transaction completed after March 4, 2003; (2) the former shareholders of the domestic corporation hold (by reason of the stock they had held in the domestic corporation) at least 60 percent but less than 80 percent (by vote or value) of the stock of the foreign-incorporated entity after the transaction (this stock often being referred to as "stock held by reason of"); and (3) the foreign-incorporated entity, considered together with all companies connected to it by a chain of greater than 50 percent ownership (that is, the "expanded affiliated group"), does not have substantial business activities in the entity's country of incorporation, compared to the total worldwide business activities of the expanded affiliated group.[772]

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[766] Sec. 7701(a)(30).

[767] Sec. 7701(b).

[768] Sec. 7701(a)(4).

[769] Secs. 7701(a)(5) and 7701(a)(9). Entities organized in a possession or territory of the United States are not considered to have been organized under the laws of the United States.

[770] "The notion of corporate residence is an important touchstone of taxation, however, in many foreign income tax systems[,]" with the result that the bilateral treaties are often relied upon to resolve conflicting claims of taxing jurisdiction. Joseph Isenbergh, Vol. 1 *U.S. Taxation of Foreign Persons and Foreign Income*, Para. 7.1 (Fourth Ed. 2016).

[771] Sec. 7874.

[772] Sec. 7874(a). In addition, an excise tax may be imposed on certain stock compensation of executives of companies that undertake inversion transactions. Sec. 4985.

The Treasury Department and the IRS have promulgated detailed guidance, through both regulations and several notices, addressing these requirements under section 7874 since the section was enacted in 2004,[773] and have sought to expand the reach of the section or reduce the tax benefits of inversion transactions. For example, Notice 2014–52 announced Treasury's and the IRS's intention to issue regulations and took a two-pronged approached. First, it addressed the treatment of cross-border combination transactions themselves. Second, it addressed post-transaction steps that taxpayers may undertake with respect to U.S.-owned foreign subsidiaries making it more difficult to access foreign earnings without incurring added U.S. tax. On November 19, 2015, Treasury and the IRS issued Notice 2015–79, which announced their intent to issue further regulations to limit cross-border merger transactions, expanding on the guidance issued in Notice 2014–52. In 2016, Treasury and the IRS issued proposed and temporary regulations that incorporate the rules previously announced in Notice 2014–52 and Notice 2015–79 and a new multiple domestic entity acquisition rule.[774]

In early 2017, Treasury issued final and temporary regulations[775] that adopt, with few changes, the prior temporary and proposed regulations.

2. Entity classification

Certain entities are eligible to elect their classification for Federal tax purposes under the "check-the-box" regulations adopted in 1997.[776] Those regulations simplified the entity classification process for both taxpayers and the IRS by making the entity classification of unincorporated entities explicitly elective in most instances.[777] The eligibility to elect and the breadth of an entity's choices depend upon whether it is a "per se corporation" and its number of beneficial owners. Foreign as well as domestic entities may make the election. As a result, it is possible for an entity that operates across countries to be treated as a hybrid entity. A hybrid entity is one which is treated as a flow-through or disregarded enti-

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[773] Notice 2015–79, 2015 I.R.B. LEXIS 583 (Nov. 19, 2015), which announced their intent to issue further regulations to limit cross-border merger transactions, expanding on the guidance issued in Notice 2014–52. On April 4, 2016, Treasury and the IRS issued proposed and temporary regulations (T.D. 9761) that incorporate the rules previously announced in Notice 2014–52 and Notice 2015–79 and a new multiple domestic entity acquisition rule. On January 13, 2017, Treasury and the IRS issued final and temporary regulations under section 7874 (T.D. 9812), which adopt, with few changes, prior temporary and proposed regulations, which identify certain stock of an acquiring foreign corporation that is disregarded in calculating the ownership of the foreign corporation for purposes of section 7874.

[774] T.D. 9761, April 4, 2016. But see, *Chamber of Commerce v Internal Revenue Service*, Cause No 1:16–CV–944–LY (W.D. Tex. Sept. 29, 2017), granting summary judgment to plaintiff in challenge to temporary regulations based on lack of compliance with Administrative Procedure Requirements.

[775] T.D. 9812, January 13, 2017.

[776] Treas. Reg. sec. 301.7701–1, *et seq.*

[777] The check-the-box regulations replaced Treas. Reg. sec. 301.7701–2, as in effect prior to 1997, under which the classification of unincorporated entities for Federal tax purposes was determined on the basis of a four characteristics indicative of status as a corporation: continuity of life, centralization of management, limited liability, and free transferability of interests. An entity that possessed three or more of these characteristics was treated as a corporation; if it possessed two or fewer, then it was treated as a partnership. Thus, to achieve characterization as a partnership under this system, taxpayers needed to arrange the governing instruments of an entity in such a way as to eliminate two of these corporate characteristics. The advent and proliferation of limited liability companies ("LLCs") under State laws allowed business owners to create customized entities that possessed a critical common feature—limited liability for investors—as well as other corporate characteristics the owners found desirable. As a consequence, classification was effectively elective for well-advised taxpayers.

ty for U.S. tax purposes but as a corporation for foreign tax purposes. For "reverse hybrid entities," the opposite is true. The election can affect the determination of the source of the income, availability of tax credits, and other tax attributes.

3. Source of income rules

The rules for determining the source of certain types of income are specified in the Code and described briefly below. Various factors determine the source of income for U.S. tax purposes, including the status or nationality of the payor, the status or nationality of the recipient, the location of the recipient's activities that generate the income, and the location of the assets that generate the income. To the extent that the source of income is not specified by statute, the Treasury Secretary may promulgate regulations that explain the appropriate treatment. However, many items of income are not explicitly addressed by either the Code or Treasury regulations, sometimes resulting in nontaxation of the income. On several occasions, courts have determined the source of such items by applying the rule for the type of income to which the disputed income is most closely analogous, based on all facts and circumstances.[778]

Interest

Interest is derived from U.S. sources if it is paid by the United States or any agency or instrumentality thereof, a State or any political subdivision thereof, or the District of Columbia. Interest is also from U.S. sources if it is paid by a resident or a domestic corporation on a bond, note, or other interest-bearing obligation.[779] Special rules apply to treat as foreign-source certain amounts paid on deposits with foreign commercial banking branches of U.S. corporations or partnerships and certain other amounts paid by foreign branches of domestic financial institutions.[780] Interest paid by the U.S. branch of a foreign corporation is also treated as U.S.-source income.[781]

Dividends

Dividend income is generally sourced by reference to the payor's place of incorporation.[782] Thus, dividends paid by a domestic corporation are generally treated as entirely U.S.-source income. Similarly, dividends paid by a foreign corporation are generally treated as entirely foreign-source income. Under a special rule, dividends from certain foreign corporations that conduct U.S. businesses are treated in part as U.S.-source income.[783]

Rents and royalties

Rental income is sourced by reference to the location or place of use of the leased property.[784] The nationality or the country of resi-

[778] See, *e.g., Hunt v. Commissioner*, 90 T.C. 1289 (1988).
[779] Sec. 861(a)(1); Treas. Reg. sec. 1.861–2(a)(1).
[780] Secs. 861(a)(1) and 862(a)(1). For purposes of certain reporting and withholding obligations the source rule in section 861(a)(1)(B) does not apply to interest paid by the foreign branch of a domestic financial institution. This results in the payment being treated as a withholdable payment. Sec. 1473(1)(C).
[781] Sec. 884(f)(1).
[782] Secs. 861(a)(2), 862(a)(2).
[783] Sec. 861(a)(2)(B).
[784] Sec. 861(a)(4).

dence of the lessor or lessee does not affect the source of rental income. Rental income from property located or used in the United States (or from any interest in such property) is U.S.-source income, regardless of whether the property is real or personal, intangible or tangible.

Royalties are sourced in the place of use of (or the place of privilege to use) the property for which the royalties are paid.[785] This source rule applies to royalties for the use of either tangible or intangible property, including patents, copyrights, secret processes, formulas, goodwill, trademarks, trade names, and franchises.

Income from sales of personal property

Subject to significant exceptions, income from the sale of personal property is sourced on the basis of the residence of the seller.[786] For this purpose, special definitions of the terms "U.S. resident" and "nonresident" are provided. A nonresident is defined as any person who is not a U.S. resident,[787] while the term "U.S. resident" comprises any juridical entity which is a U.S. person, all U.S. citizens, as well as any individual who is a U.S. resident without a tax home in a foreign country or a nonresident alien with a tax home in the United States.[788] As a result, nonresident includes any foreign corporation.[789]

Several special rules apply. For example, income from the sale of inventory property is generally sourced to the place of sale, which is determined by where title to the property passes.[790] However, if the sale is by a nonresident and is attributable to an office or other fixed place of business in the United States, the sale is treated as income from U.S. sources without regard to the place of sale, unless it is sold for use, disposition, or consumption outside the United States and a foreign office materially participates in the sale.[791] Income from the sale of inventory property that a taxpayer produces (in whole or in part) in the United States and sells outside the United States, or that a taxpayer produces (in whole or in part) outside the United States and sells in the United States, is treated as partly U.S.-source and partly foreign-source.[792]

In determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the IRS has taken the position that to the extent that there is unrealized gain attributable to partnership assets that are effectively connected with the

[785] *Ibid.*
[786] Sec. 865(a).
[787] Sec. 865(g)(1)(B).
[788] Sec. 865(g)(1)(A).
[789] Sec. 865(g).
[790] Secs. 865(b), 861(a)(6), 862(a)(6); Treas. Reg. sec. 1.861–7(c).
[791] Sec. 865(e)(2).
[792] Sec. 863(b). A taxpayer may elect one of three methods for allocating and apportioning income as U.S.-or foreign-source: (1) the 50–50 method under which 50 percent of the income from the sale of inventory property in such a situation is attributable to the production activities and 50 percent to the sales activities, with the income sourced based on the location of those activities; (2) independent factory price ("IFP") method under which, in certain circumstances, an IFP may be established by the taxpayer to determine income from production activities; (3) the books and records method under which, with advance permission, the taxpayer may use books of account to detail the allocation of receipts and expenditures between production and sales activities. Treas. Reg. sec. 1.863–3(b), (c). If production activity occurs only within the United States, or only within foreign countries, then all income is sourced to where the production activity occurs; when production activities occur in both the United States and one or more foreign countries, the income attributable to production activities must be split between U.S. and foreign sources. Treas. Reg. sec. 1.863–3(c)(1). The sales activity is generally sourced based on where title to the property passes. Treas. Reg. secs. 1.863–3(c)(2), 1.861–7(c).

U.S. business, the foreign person's gain or loss from the sale or exchange of a partnership interest is effectively connected gain or loss to the extent of the partner's distributive share of such unrealized gain or loss, and not capital gain or loss. Similarly, to the extent that the partner's distributive share of unrealized gain is attributable to a permanent establishment of the partnership under an applicable treaty provision, it may be subject to U.S. tax under a treaty.[793]

Gain on the sale of depreciable property is divided between U.S.-source and foreign-source in the same ratio that the depreciation was previously deductible for U.S. tax purposes.[794] Payments received on sales of intangible property are sourced in the same manner as royalties to the extent the payments are contingent on the productivity, use, or disposition of the intangible property.[795]

Personal services income

Compensation for labor or personal services is generally sourced to the place-of-performance. Thus, compensation for labor or personal services performed in the United States generally is treated as U.S.-source income, subject to an exception for amounts that meet certain *de minimis* criteria.[796] Compensation for services performed both within and without the United States is allocated between U.S.- and foreign-source.[797]

Insurance income

Underwriting income from issuing insurance or annuity contracts generally is treated as U.S.-source income if the contract involves property in, liability arising out of an activity in, or the lives or health of residents of, the United States.[798]

Transportation income

Sources rules generally provide that income from furnishing transportation that both begins and ends in the United States is U.S.-source income,[799] and 50-percent of income attributable to transportation that either begins or ends in the United States is treated as U.S.-source income. However, to the extent that the operator of a shipping or cruise line is foreign, its ownership structure and the maritime law[800] applicable for determining what constitutes international shipping, as well as specific income tax provi-

[793] Rev. Rul. 91–32, 1991–1 C.B. 107. But see, *Grecian Magnesite Mining, Industrial & Shipping Co. SA v Commissioner*, 149 T.C. No. 3 (2017).
[794] Sec. 865(c).
[795] Sec. 865(d).
[796] Sec. 861(a)(3). Gross income of a nonresident alien individual, who is present in the United States as a member of the regular crew of a foreign vessel, from the performance of personal services in connection with the international operation of a ship is generally treated as foreign-source income.
[797] Treas. Reg. sec. 1.861–4(b).
[798] Sec. 861(a)(7).
[799] Sec. 863(c).
[800] U.S. law on navigation is codified in U.S. Code at title 33, and is consistent with the body of international maritime law. The normative principles of international maritime law for determining the maritime zones and territorial sovereignty over seas are embodied in the United Nations Convention on the Law of the Sea, first opened for signature in 1982. Since 1983, the Executive Branch has agreed that the treaty is generally consistent with existing international norms of the law of the sea and that the United States would act in conformity to the principles of the treaty other than those portions regarding deep seabed exploitation, even in the absence of ratification of the treaty.

sions, combine to create an industry-specific departure from the rules generally applicable.[801]

Income from space or ocean activities or international communications

In the case of a foreign person, generally no income from a space or ocean activity or from international communications is treated as U.S.-source income.[802] With respect to the latter, an exception is provided if the foreign person maintains an office or other fixed place of business in the United States, in which case the international communications income attributable to such fixed place of business is treated as U.S.-source income.[803] For U.S. persons, all income from space or ocean activities and 50 percent of income from international communications is treated as U.S.-source income.

Amounts received with respect to guarantees of indebtedness

Amounts received, directly or indirectly, from a noncorporate resident or from a domestic corporation for the provision of a guarantee of indebtedness of such person are income from U.S. sources.[804] This includes payments that are made indirectly for the provision of a guarantee. For example, U.S.-source income under this rule includes a guarantee fee paid by a foreign bank to a foreign corporation for the foreign corporation's guarantee of indebtedness owed to the bank by the foreign corporation's domestic subsidiary, where the cost of the guarantee fee is passed on to the domestic subsidiary through, for instance, additional interest charged on the indebtedness. In this situation, the domestic subsidiary has paid the guarantee fee as an economic matter through higher interest costs, and the additional interest payments made by the subsidiary are treated as indirect payments of the guarantee fee and, therefore, as income from U.S. sources.

Such U.S.-source income also includes amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of indebtedness of that foreign person if the payments received are connected with income of such person that is effectively connected with the conduct of a U.S. trade or business. Amounts received from a foreign person, whether directly or indirectly, for the provision of a guarantee of that person's debt, are

[801] Due to the regulatory framework for aviation, an international flight must either originate or conclude in the country of residence of the airline's owner, where income tax for the international flight is assessed. In contrast to international shipping, international aviation cannot be carried out using flags-of-convenience. Thus, although tax law treats shipping and aviation similarly, the differences between the two industries and the applicable regulatory regimes produce different tax outcomes. Full territorial sovereignty applies within 12 nautical miles of one's coast; the contiguous waters beyond 12 nautical miles but up to 24 nautical miles are subject to some regulation. Within 200 nautical miles, a country may assert an economic zone for exploitation of living marine resources and some minerals. Beyond 200 nautical miles are the "high seas" in which no sovereign state may assert exclusive jurisdiction.

[802] Sec. 863(d).

[803] Sec. 863(e).

[804] Sec. 861(a)(9). This provision effects a legislative override of the opinion in *Container Corp. v. Commissioner*, 134 T.C. 122 (February 17, 2010), aff'd 2011 WL1664358, 107 A.F.T.R.2d 2011–1831 (5th Cir. May 2, 2011), in which the Tax Court held that fees paid by a domestic corporation to its foreign parent with respect to guarantees issued by the parent for the debts of the domestic corporation were more closely analogous to compensation for services than to interest, and determined that the source of the fees should be determined by reference to the residence of the foreign parent-guarantor. As a result, the income was treated as income from foreign sources.

treated as foreign-source income if they are not from sources within the United States under section 861(a)(9).

4. Intercompany transfers

Transfer pricing

A basic U.S. tax principle applicable in dividing profits from transactions between related taxpayers is that the amount of profit allocated to each related taxpayer must be measured by reference to the amount of profit that a similarly situated taxpayer would realize in similar transactions with unrelated parties. The transfer pricing rules of section 482 and the accompanying Treasury regulations are intended to preserve the U.S. tax base by ensuring that taxpayers do not shift income properly attributable to the United States to a related foreign company through pricing that does not reflect an arm's-length result.[805] Similarly, the domestic laws of most U.S. trading partners include rules to limit income shifting through transfer pricing. The arm's-length standard is difficult to administer in situations in which no unrelated party market prices exist for transactions between related parties. When a foreign person with U.S. activities has transactions with related U.S. taxpayers, the amount of income attributable to U.S. activities is determined in part by the same transfer pricing rules of section 482 that apply when U.S. persons with foreign activities transact with related foreign taxpayers.

Section 482 authorizes the Secretary of the Treasury to allocate income, deductions, credits, or allowances among related business entities[806] when necessary to clearly reflect income or otherwise prevent tax avoidance, and comprehensive Treasury regulations under that section adopt the arm's-length standard as the method for determining whether allocations are appropriate.[807] The regulations generally attempt to identify the respective amounts of taxable income of the related parties that would have resulted if the parties had been unrelated parties dealing at arm's length. For income from intangible property, section 482 provides "in the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible." By requiring inclusion in income of amounts commensurate with the income attributable to the intangible, Congress was responding to concerns regarding the effectiveness of the arm's-length standard with respect to intangible property—including, in particular, high-profit-potential intangibles.[808]

[805] For a detailed description of the U.S. transfer pricing rules, see Joint Committee on Taxation, *Present Law and Background Related to Possible Income Shifting and Transfer Pricing* (JCX–37–10), July 20, 2010, pp. 18–50.

[806] The term "related" as used herein refers to relationships described in section 482, which refers to "two or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests."

[807] Section 1059A buttresses section 482 by limiting the extent to which costs used to determine custom valuation can also be used to determine basis in property imported from a related party. A taxpayer that imports property from a related party may not assign a value to the property for cost purposes that exceeds its customs value.

[808] H.R. Rep. No. 99–426, p. 423.

Gain recognition on outbound transfers

If a transfer of intangible property to a foreign affiliate occurs in connection with certain corporate transactions, nonrecognition rules that may otherwise apply are suspended. The transferor of intangible property must recognize gain from the transfer as though he had sold the intangible (regardless of the stage of development of the intangible property) in exchange for payments contingent on the use, productivity or disposition of the transferred property in amounts that would have been received either annually over the useful life of the property or upon disposition of the property after the transfer.[809] The appropriate amounts of those imputed payments are determined using transfer-pricing principles. Final regulations issued in 2016 eliminate an exception under temporary regulations that permitted nonrecognition of gain from outbound transfers of foreign goodwill and going concern value. However, the Secretary announced that reinstatement of an exception for active trades or businesses is under consideration for cases with little potential for abuse and administrative difficulties.[810]

B. U.S. Tax Rules Applicable to Nonresident Aliens and Foreign Corporations (Inbound)

Nonresident aliens and foreign corporations are generally subject to U.S. tax only on their U.S.-source income. Thus, the source and type of income received by a foreign person generally determines whether there is any U.S. income tax liability and the mechanism by which it is taxed. The U.S. tax rules for U.S. activities of foreign taxpayers apply differently to two broad types of income: U.S.-source income that is "fixed or determinable annual or periodical gains, profits, and income" ("FDAP income") or income that is "effectively connected with the conduct of a trade or business within the United States" ("ECI"). FDAP income generally is subject to a 30-percent gross-basis tax withheld at its source, while ECI is generally subject to the same U.S. tax rules that apply to business income derived by U.S. persons. That is, deductions are permitted in determining taxable ECI, which is then taxed at the same rates applicable to U.S. persons. Much FDAP income and similar income is, however, exempt from tax or is subject to a reduced rate of tax under the Code[811] or a bilateral income tax treaty.[812]

1. Gross-basis taxation of U.S.-source income

Non-business income received by foreign persons from U.S. sources is generally subject to tax on a gross basis at a rate of 30

[809] Sec. 367(d).

[810] See, T.D. 9803, 81 F.R. 91012 (December 17, 2016). Treas. Reg. sec. 1.367(d)–1(b) now provides that the rules of section 367(d) apply to transfers of intangible property as defined under Treas. Sec. 1.367(a)–1(d)(5) after September 14, 2015, and to any transfers occurring before that date resulting from entity classification elections filed on or after September 15, 2015. Noting that commenters on the regulations had cited legislative history that contemplated active business exceptions, Treasury announced the reconsideration of the rule. U.S. Treasury Department, *Second Report to the President on Identifying and Reducing Tax Regulatory Burdens, Executive Order 13789* October 2, 2017, TNT Doc 2017–72131. The relevant legislative history is found at in H.R. Rep. No. 98–432, 98th Cong., 2d Sess. 1318–1320 (March 5, 1984) and Conference Report, H.R. Rep. No. 98–861, 98th Cong. 2d Sess. 951–957 (June 23, 1984).

[811] *E.g.*, the portfolio interest exception in section 871(h) (discussed below).

[812] Because each treaty reflects considerations unique to the relationship between the two treaty countries, treaty withholding tax rates on each category of income are not uniform across treaties.

percent, which is collected by withholding at the source of the payment. As explained below, the categories of income subject to the 30-percent tax and the categories for which withholding is required are generally coextensive, with the result that determining the withholding tax liability determines the substantive liability.

The income of non-resident aliens or foreign corporations that is subject to tax at a rate of 30-percent includes FDAP income that is not effectively connected with the conduct of a U.S. trade or business.[813] The items enumerated in defining FDAP income are illustrative; the common characteristic of types of FDAP income is that taxes with respect to the income may be readily computed and collected at the source, in contrast to the administrative difficulty involved in determining the seller's basis and resulting gain from sales of property.[814] The words "annual or periodical" are "merely generally descriptive" of the payments that could be within the purview of the statute and do not preclude application of the withholding tax to one-time, lump sum payments to nonresident aliens.[815]

With respect to income from shipping, the gross basis tax potentially applicable is four percent,[816] unless the income is effectively connected with a U.S. trade or business, and thus subject to the graduated rates, as determined under rules specific to U.S.-source gross transportation income rather than the more broadly applicable rules defining effectively connected income in section 864(c). Even if the income is within the purview of those special rules, it may nevertheless be exempt if the income is derived from the international operation of a ship or aircraft by a foreign entity organized in a jurisdiction which provides a reciprocal exemption to U.S. entities.[817]

Types of FDAP income

FDAP income encompasses a broad range of types of gross income, but has limited application to gains on sales of property, including market discount on bonds and option premiums.[818] Capital gains received by nonresident aliens present in the United States for fewer than 183 days are generally treated as foreign source and are thus not subject to U.S. tax, unless the gains are effectively connected with a U.S. trade or business; capital gains received by nonresident aliens present in the United States for 183 days or

[813] Secs. 871(a), 881. If the FDAP income is also ECI, it is taxed on a net basis, at graduated rates.

[814] *Commissioner* v. *Wodehouse,* 337 U.S. 369, 388–89 (1949). After reviewing legislative history of the Revenue Act of 1936, the Supreme Court noted that Congress expressly intended to limit taxes on nonresident aliens to taxes that could be readily collectible, *i.e.,* subject to withholding, in response to "a theoretical system impractical of administration in a great number of cases. H.R. Rep. No. 2475, 74th Cong., 2d Sess. 9–10 (1936)." In doing so, the Court rejected P.G. Wodehouse's arguments that an advance royalty payment was not within the purview of the statutory definition of FDAP income.

[815] 815*Commissioner* v. *Wodehouse,* 337 U.S. 369, 393 (1949).

[816] Sec. 887.

[817] Sec. 883(a)(1). In addition, to the extent provided in regulations, income from shipping and aviation is not subject to the four-percent gross basis tax if the income is of a type that is not subject to the reciprocal exemption for net basis taxation. See sec. 887(b)(1). Comparable rules under section 872(b)(1) apply to income of nonresident alien individuals from shipping operations.

[818] Although technically insurance premiums paid to a foreign insurer or reinsurer are FDAP income, they are exempt from withholding under Treas. Reg. sec. 1.1441–2(a)(7) if the insurance contract is subject to the excise tax under section 4371. Treas. Reg. secs. 1.1441–2(b)(1)(i) and 1.1441–2(b)(2).

more[819] that are treated as income from U.S. sources are subject to gross-basis taxation.[820] In contrast, U.S-source gains from the sale or exchange of intangibles are subject to tax and withholding if they are contingent upon the productivity of the property sold and are not effectively connected with a U.S. trade or business.[821]

Interest on bank deposits may qualify for exemption on two grounds, depending on where the underlying principal is held on deposit. Interest paid with respect to deposits with domestic banks and savings and loan associations, and certain amounts held by insurance companies, are U.S.-source income but are not subject to the U.S. tax when paid to a foreign person, unless the interest is effectively connected with a U.S. trade or business of the recipient.[822] Interest on deposits with foreign branches of domestic banks and domestic savings and loan associations is not treated as U.S.-source income and is thus exempt from U.S. tax (regardless of whether the recipient is engaged in a U.S. trade or business).[823] Similarly, interest and original issue discount on certain short-term obligations is also exempt from U.S. tax when paid to a foreign person.[824] Additionally, there is generally no information reporting required with respect to payments of such amounts.[825]

Although FDAP income includes U.S.-source portfolio interest, such interest is specifically exempt from the 30-percent gross-basis tax. Portfolio interest is any interest (including original issue discount) that is paid on an obligation that is in registered form and for which the beneficial owner has provided to the U.S. withholding agent a statement certifying that the beneficial owner is not a U.S. person.[826] For obligations issued before March 19, 2012, portfolio interest also includes interest paid on an obligation that is not in registered form, provided that the obligation is shown to be targeted to foreign investors under the conditions sufficient to establish deductibility of the payment of such interest.[827] Portfolio interest, however, does not include interest received by a 10-percent shareholder,[828] certain contingent interest,[829] interest received by a controlled foreign corporation from a related person,[830] or interest received by a bank on an extension of credit made pursuant to

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[819] For purposes of this rule, whether a person is considered a resident in the United States is determined by application of the rules under section 7701(b).

[820] Sec. 871(a)(2). In addition, certain capital gains from sales of U.S. real property interests are subject to tax as effectively connected income (or in some instances as dividend income) under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA").

[821] Secs. 871(a)(1)(D), 881(a)(4).

[822] Secs. 871(i)(2)(A), 881(d); Treas. Reg. sec. 1.1441–1(b)(4)(ii).

[823] Sec. 861(a)(1)(B); Treas. Reg. sec. 1.1441–1(b)(4)(iii).

[824] Secs. 871(g)(1)(B), 881(a)(3); Treas. Reg. sec. 1.1441–1(b)(4)(iv).

[825] Treas. Reg. sec. 1.1461–1(c)(2)(ii)(A), (B). Regulations require a bank to report interest if the recipient is a nonresident alien who resides in a country with which the United States has a satisfactory exchange of information program under a bilateral agreement and the deposit is maintained at an office in the United States. Treas. Reg. secs. 1.6049–4(b)(5) and 1.6049–8. The IRS publishes lists of the countries whose residents are subject to the reporting requirements, and those countries with respect to which the reported information will be automatically exchanged. Rev. Proc. 2017–31, available at https://www.irs.gov/pub/irs-drop/rp-17-31.pdf, supplementing Rev. Proc. 2014–64.

[826] Sec. 871(h)(2).

[827] Sec. 163(f)(2)(B). The exception to the registration requirements for foreign targeted securities was repealed in 2010, effective for obligations issued two years after enactment, thus narrowing the portfolio interest exemption for obligations issued after March 18, 2012. See Hiring Incentives to Restore Employment Law of 2010, Pub. L. No. 111–147, sec. 502(b).

[828] Sec. 871(h)(3).

[829] Sec. 871(h)(4).

[830] Sec. 881(c)(3)(C).

a loan agreement entered into in the ordinary course of its trade or business.[831]

Imposition of gross-basis tax and reporting by U.S. withholding agents

The 30-percent tax on FDAP income is generally collected by means of withholding.[832] Withholding on FDAP payments to foreign payees is required unless the withholding agent,[833] i.e., the person making the payment to the foreign person receiving the income, can establish that the beneficial owner of the amount is eligible for an exemption from withholding or a reduced rate of withholding under an income tax treaty.[834] The principal statutory exemptions from the 30-percent tax apply to interest on bank deposits, and portfolio interest, described above.[835]

In many instances, the income subject to withholding is the only income of the foreign recipient that is subject to any U.S. tax. No U.S. Federal income tax return from the foreign recipient is generally required with respect to the income from which tax was withheld, if the recipient has no ECI income and the withholding is sufficient to satisfy the recipient's liability. Accordingly, although the 30-percent gross-basis tax is a withholding tax, it is also generally the final tax liability of the foreign recipient (unless the foreign recipients files for a refund).

A withholding agent that makes payments of U.S.-source amounts to a foreign person is required to report and pay over any amounts of U.S. tax withheld. The reports are due to be filed with the IRS by March 15 of the calendar year following the year in which the payment is made. Two types of reports are required: (1) a summary of the total U.S.-source income paid and withholding tax withheld on foreign persons for the year and (2) a report to both the IRS and the foreign person of that person's U.S.-source income that is subject to reporting.[836] The nonresident withholding rules apply broadly to any financial institution or other payor, including foreign financial institutions.[837]

To the extent that the withholding agent deducts and withholds an amount, the withheld tax is credited to the recipient of the income.[838] If the agent withholds more than is required, and results in an overpayment of tax, the excess may be refunded to the recipient of the income upon filing of a timely claim for refund.

Excise tax on foreign reinsurance premiums

An excise tax applies to premiums paid to foreign insurers and reinsurers covering U.S. risks.[839] The excise tax is imposed on a

[831] Sec. 881(c)(3)(A).
[832] Secs. 1441, 1442.
[833] Withholding agent is defined broadly to include any U.S. or foreign person that has the control, receipt, custody, disposal, or payment of an item of income of a foreign person subject to withholding. Treas. Reg. sec. 1.1441–7(a).
[834] Secs. 871, 881, 1441, 1442; Treas. Reg. sec. 1.1441–1(b).
[835] A reduced rate of withholding of 14 percent applies to certain scholarships and fellowships paid to individuals temporarily present in the United States. Sec. 1441(b). In addition to statutory exemptions, the 30percent tax with respect to interest, dividends and royalties may be reduced or eliminated by a tax treaty between the United States and the country in which the recipient of income otherwise subject to tax is resident.
[836] Treas. Reg. sec. 1.1461–1(b), (c).
[837] See Treas. Reg. sec. 1.1441–7(a) (definition of withholding agent includes foreign persons).
[838] Sec. 1462.
[839] Secs. 4371–4374.

gross basis at the rate of one percent on reinsurance and life insurance premiums, and at the rate of four percent on property and casualty insurance premiums. The excise tax does not apply to premiums that are effectively connected with the conduct of a U.S. trade or business or that are exempted from the excise tax under an applicable income tax treaty. The excise tax paid by one party cannot be credited if, for example, the risk is reinsured with a second party in a transaction that is also subject to the excise tax.

Many U.S. tax treaties provide an exemption from the excise tax, including the treaties with Germany, Japan, Switzerland, and the United Kingdom.[840] To prevent persons from inappropriately obtaining the benefits of exemption from the excise tax, the treaties generally include an anti-conduit rule. The most common anti-conduit rule provides that the treaty exemption applies to the excise tax only to the extent that the risks covered by the premiums are not reinsured with a person not entitled to the benefits of the treaty (or any other treaty that provides exemption from the excise tax).[841]

2. Net-basis taxation of U.S.-source income

The United States taxes on a net basis the income of foreign persons that is "effectively connected" with the conduct of a trade or business in the United States.[842] Any gross income derived by the foreign person that is not effectively connected with the person's U.S. business is not taken into account in determining the rates of U.S. tax applicable to the person's income from the business.[843]

U.S. trade or business

A foreign person is subject to U.S. tax on a net basis if the person is engaged in a U.S. trade or business. Partners in a partnership and beneficiaries of an estate or trust are treated as engaged in the conduct of a trade or business within the United States if the partnership, estate, or trust is so engaged.[844]

The question whether a foreign person is engaged in a U.S. trade or business is factual and has generated much case law. Basic issues include whether the activity constitutes business rather than investing, whether sufficient activities in connection with the business are conducted in the United States, and whether the relationship between the foreign person and persons performing functions in the United States in respect of the business is sufficient to attribute those functions to the foreign person.

[840] Generally, when a foreign person qualifies for benefits under such a treaty, the United States is not permitted to collect the insurance premiums excise tax from that person.

[841] In Rev. Rul. 2008–15, 2008–1 C.B. 633, the IRS provided guidance to the effect that the excise tax is imposed separately on each reinsurance policy covering a U.S. risk. Thus, if a U.S. insurer or reinsurer reinsures a U.S. risk with a foreign reinsurer, and that foreign reinsurer in turn reinsures the risk with a second foreign reinsurer, the excise tax applies to both the premium to the first foreign reinsurer and the premium to the second foreign reinsurer. In addition, if the first foreign reinsurer is resident in a jurisdiction with a tax treaty containing an excise tax exemption, the revenue ruling provides that the excise tax still applies to both payments to the extent that the transaction violates an anti-conduit rule in the applicable tax treaty. Even if no violation of an anti-conduit rule occurs, under the revenue ruling, the excise tax still applies to the premiums paid to the second foreign reinsurer, unless the second foreign reinsurer is itself entitled to an excise tax exemption.

[842] Secs. 871(b), 882.

[843] Secs. 871(b)(2), 882(a)(2).

[844] Sec. 875.

The trade or business rules differ from one activity to another. The term "trade or business within the United States" expressly includes the performance of personal services within the United States.[845] If, however, a nonresident alien individual performs personal services for a foreign employer, and the individual's total compensation for the services and period in the United States are minimal ($3,000 or less in total compensation and 90 days or fewer of physical presence in a year), the individual is not considered to be engaged in a U.S. trade or business.[846] Detailed rules govern whether trading in stocks or securities or commodities constitutes the conduct of a U.S. trade or business.[847] A foreign person who trades in stock or securities or commodities in the United States through an independent agent generally is not treated as engaged in a U.S. trade or business if the foreign person does not have an office or other fixed place of business in the United States through which trades are carried out. A foreign person who trades stock or securities or commodities for the person's own account also generally is not considered to be engaged in a U.S. business so long as the foreign person is not a dealer in stock or securities or commodities.

For eligible foreign persons, U.S. bilateral income tax treaties restrict the application of net-basis U.S. taxation. Under each treaty, the United States is permitted to tax business profits only to the extent those profits are attributable to a U.S. permanent establishment of the foreign person. The threshold level of activities that constitute a permanent establishment is generally higher than the threshold level of activities that constitute a U.S. trade or business. For example, a permanent establishment typically requires the maintenance of a fixed place of business over a significant period of time.

Effectively connected income

A foreign person that is engaged in the conduct of a trade or business within the United States is subject to U.S. net-basis taxation on the income that is "effectively connected" with the business. Specific statutory rules govern whether income is ECI.[848]

In the case of U.S.-source capital gain and U.S.-source income of a type that would be subject to gross basis U.S. taxation, the factors taken into account in determining whether the income is ECI include whether the income is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the amount (the "asset use" and "business activities" tests).[849] Under the asset use and business activities tests, due regard is given to whether the income, gain, or asset was accounted for through the U.S. trade or business. All other U.S.-source income is treated as ECI.[850]

A foreign person who is engaged in a U.S. trade or business may have limited categories of foreign-source income that are considered

[845] Sec. 864(b).
[846] Sec. 864(b)(1).
[847] Sec. 864(b)(2).
[848] Sec. 864(c).
[849] Sec. 864(c)(2).
[850] Sec. 864(c)(3).

to be ECI.[851] Foreign-source income not included in one of these categories (described next) generally is exempt from U.S. tax.

A foreign person's income from foreign sources generally is considered to be ECI only if the person has an office or other fixed place of business within the United States to which the income is attributable and the income is in one of the following categories: (1) rents or royalties for the use of patents, copyrights, secret processes or formulas, good will, trade-marks, trade brands, franchises, or other like intangible properties derived in the active conduct of the trade or business; (2) interest or dividends derived in the active conduct of a banking, financing, or similar business within the United States or received by a corporation the principal business of which is trading in stocks or securities for its own account; or (3) income derived from the sale or exchange (outside the United States), through the U.S. office or fixed place of business, of inventory or property held by the foreign person primarily for sale to customers in the ordinary course of the trade or business, unless the sale or exchange is for use, consumption, or disposition outside the United States and an office or other fixed place of business of the foreign person in a foreign country participated materially in the sale or exchange.[852] Foreign-source dividends, interest, and royalties are not treated as ECI if the items are paid by a foreign corporation more than 50 percent (by vote) of which is owned directly, indirectly, or constructively by the recipient of the income.[853]

In determining whether a foreign person has a U.S. office or other fixed place of business, the office or other fixed place of business of an agent generally is disregarded. The place of business of an agent other than an independent agent acting in the ordinary course of business is not disregarded, however, if the agent either has the authority (regularly exercised) to negotiate and conclude contracts in the name of the foreign person or has a stock of merchandise from which he regularly fills orders on behalf of the foreign person.[854] If a foreign person has a U.S. office or fixed place of business, income, gain, deduction, or loss is not considered attributable to the office unless the office was a material factor in the production of the income, gain, deduction, or loss and the office regularly carries on activities of the type from which the income, gain, deduction, or loss was derived.[855]

Special rules apply in determining the ECI of an insurance company. The foreign-source income of a foreign corporation that is subject to tax under the insurance company provisions of the Code is treated as ECI if the income is attributable to its United States business.[856]

Income, gain, deduction, or loss for a particular year generally is not treated as ECI if the foreign person is not engaged in a U.S. trade or business in that year.[857] If, however, income or gain taken into account for a taxable year is attributable to the sale or ex-

[851] This income is subject to net-basis U.S. taxation after allowance of a credit for any foreign income tax imposed on the income. Sec. 906.
[852] Sec. 864(c)(4)(B).
[853] Sec. 864(c)(4)(D)(i).
[854] Sec. 864(c)(5)(A).
[855] Sec. 864(c)(5)(B).
[856] Sec. 864(c)(4)(C).
[857] Sec. 864(c)(1)(B).

change of property, the performance of services, or any other transaction that occurred in a prior taxable year, the determination whether the income or gain is taxable on a net basis is made as if the income were taken into account in the earlier year and without regard to the requirement that the taxpayer be engaged in a trade or business within the United States during the later taxable year.[858] If any property ceases to be used or held for use in connection with the conduct of a U.S. trade or business and the property is disposed of within 10 years after the cessation, the determination whether any income or gain attributable to the disposition of the property is taxable on a net basis is made as if the disposition occurred immediately before the property ceased to be used or held for use in connection with the conduct of a U.S. trade or business and without regard to the requirement that the taxpayer be engaged in a U.S. business during the taxable year for which the income or gain is taken into account.[859]

Transportation income from U.S. sources is treated as effectively connected with a foreign person's conduct of a U.S. trade or business only if the foreign person has a fixed place of business in the United States that is involved in the earning of such income and substantially all of such income of the foreign person is attributable to regularly scheduled transportation.[860] If the transportation income is effectively connected with conduct of a U.S. trade or business, the transportation income, along with transportation income that is from U.S. sources because the transportation both begins and ends in the United States, may be subject to net-basis taxation. Income from the international operation of a ship or aircraft may be eligible for an exemption under section 883, provided that the foreign jurisdiction has extended reciprocity for U.S. businesses;[861] whether the party claiming an exemption is eligible for the tax relief;[862] and the activities that give rise to the income qualify under relevant regulations.

Allowance of deductions

Taxable ECI is computed by taking into account deductions associated with gross ECI. For this purpose, the apportionment and allocation of deductions is addressed in detailed regulations. The regulations applicable to deductions other than interest expense set forth general guidelines for allocating deductions among classes of income and apportioning deductions between ECI and non-ECI. In some circumstances, deductions may be allocated on the basis of units sold, gross sales or receipts, costs of goods sold, profits contributed, expenses incurred, assets used, salaries paid, space used, time spent, or gross income received. More specific guidelines are provided for the allocation and apportionment of research and experimental expenditures, legal and accounting fees, income taxes, losses on dispositions of property, and net operating losses. De-

[858] Sec. 864(c)(6).

[859] Sec. 864(c)(7).

[860] Sec. 887(b)(4).

[861] The most recent compilation of countries that the United States recognizes as providing exemptions lists countries in three groups: Twenty-seven countries are eligible for exemption on the basis of a review of the legislation in the foreign jurisdiction; 39 nations exchanged diplomatic notes with the United States that grant exemption to some extent; and more than 50 nations are parties with the United States to bilateral income tax treaties that include a shipping article. Rev. Rul. 2008–17, 2008–1 C.B. 626, modified by Ann. 2008–57, 2008–C.B. 1192, 2008.

[862] Sec. 883(c) and regulations thereunder.

tailed regulations under section 861 address the allocation and apportionment of interest deductions. In general, interest is allocated and apportioned based on assets rather than income.

3. Special rules

FIRPTA

A foreign person's gain or loss from the disposition of a U.S. real property interest ("USRPI") is treated as ECI and, therefore, as taxable at the income tax rates applicable to U.S. persons, including the rates for net capital gain. A foreign person subject to tax on this income is required to file a U.S. tax return under the normal rules relating to receipt of ECI.[863] In the case of a foreign corporation, the gain from the disposition of a USRPI may also be subject to the branch profits tax at a 30-percent rate (or lower treaty rate).

The payor of income that FIRPTA treats as ECI ("FIRPTA income") is generally required to withhold U.S. tax from the payment.[864] The foreign person can request a refund with its U.S. tax return, if appropriate, based on that person's total ECI and deductions (if any) for the taxable year.

Branch profits taxes

A domestic corporation owned by foreign persons is subject to U.S. income tax on its net income. The earnings of the domestic corporation are subject to a second tax, this time at the shareholder level, when dividends are paid. As described previously, when the shareholders are foreign, the second-level tax is imposed at a flat rate and collected by withholding. Unless the portfolio interest exemption or another exemption applies, interest payments made by a domestic corporation to foreign creditors are likewise subject to U.S. tax. To approximate these second-level withholding taxes imposed on payments made by domestic subsidiaries to their foreign parent corporations, the United States taxes a foreign corporation that is engaged in a U.S. trade or business through a U.S. branch on amounts of U.S. earnings and profits that are shifted out of, or amounts of interest that are deducted by, the U.S. branch of the foreign corporation. These branch taxes may be reduced or eliminated under an applicable income tax treaty.[865]

Under the branch profits tax, the United States imposes a tax of 30 percent on a foreign corporation's "dividend equivalent amount."[866] The dividend equivalent amount generally is the earnings and profits of a U.S. branch of a foreign corporation attributable to its ECI.[867] Limited categories of earnings and profits attributable to a foreign corporation's ECI are excluded in calculating the dividend equivalent amount.[868]

In arriving at the dividend equivalent amount, a branch's effectively connected earnings and profits are adjusted to reflect

[863] Sec. 897(a).
[864] Sec. 1445 and Treasury regulations thereunder.
[865] See Treas. Reg. sec. 1.884–1(g), –5.
[866] Sec. 884(a).
[867] Sec. 884(b).
[868] See sec. 884(d)(2) (excluding, for example, earnings and profits attributable to gain from the sale of domestic corporation stock that constitutes a U.S. real property interest described in section 897).

changes in a branch's U.S. net equity (that is, the excess of the branch's assets over its liabilities, taking into account only amounts treated as connected with its U.S. trade or business).[869] The first adjustment reduces the dividend equivalent amount to the extent the branch's earnings are reinvested in trade or business assets in the United States (or reduce U.S. trade or business liabilities). The second adjustment increases the dividend equivalent amount to the extent prior reinvested earnings are considered remitted to the home office of the foreign corporation.

Interest paid by a U.S. trade or business of a foreign corporation generally is treated as if paid by a domestic corporation and therefore is subject to U.S. 30-percent withholding tax (if the interest is paid to a foreign person and a Code or treaty exemption or reduction would not be available if the interest were actually paid by a domestic corporation).[870] Certain "excess interest" of a U.S. trade or business of a foreign corporation is treated as if paid by a U.S. corporation to a foreign parent and, therefore, is subject to U.S. 30-percent withholding tax.[871] For this purpose, excess interest is the excess of the interest expense of the foreign corporation apportioned to the U.S. trade or business over the amount of interest paid by the trade or business.

Earnings stripping

Taxpayers are limited in their ability to reduce the U.S. tax on the income derived from their U.S. operations through certain earnings stripping transactions involving interest payments. If the payor's debt-to-equity ratio exceeds 1.5 to 1 (a debt-to-equity ratio of 1.5 to 1 or less is considered a "safe harbor"), a deduction for disqualified interest paid or accrued by the payor in a taxable year is generally disallowed to the extent of the payor's excess interest expense.[872] Disqualified interest includes interest paid or accrued to related parties when no Federal income tax is imposed with respect to such interest;[873] to unrelated parties in certain instances in which a related party guarantees the debt ("guaranteed debt"); or to a REIT by a taxable REIT subsidiary of that REIT. Excess interest expense is the amount by which the payor's net interest expense (that is, the excess of interest paid or accrued over interest income) exceeds 50 percent of its adjusted taxable income (generally 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 and are allowed as a deduction to the extent of excess limitation in a subsequent tax year. In addition, any excess limitation (that is, 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.

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[869] Sec. 884(b).
[870] Sec. 884(f)(1)(A).
[871] Sec. 884(f)(1)(B).
[872] Sec. 163(j).
[873] If a tax treaty reduces the rate of tax on interest paid or accrued by the taxpayer, the interest is treated as interest on which no Federal income tax is imposed to the extent of the same proportion of such interest as the rate of tax imposed without regard to the treaty, reduced by the rate of tax imposed under the treaty, bears to the rate of tax imposed without regard to the treaty. Sec. 163(j)(5)(B).

C. U.S. Tax Rules Applicable to Foreign Activities of U.S. Persons (Outbound)

1. In general

In general, income earned directly by a U.S. person from the conduct of a foreign business is taxed on a current basis,[874] but income earned indirectly from a separate legal entity operating the foreign business is not. Instead, active foreign business income earned by a U.S. person indirectly through an interest in a foreign corporation generally is not subject to U.S. tax until the income is distributed as a dividend to the U.S. person. Certain anti-deferral regimes may cause the U.S. owner to be taxed on a current basis in the United States on certain categories of passive or highly mobile income earned by the foreign corporation regardless of whether the income has been distributed as a dividend to the U.S. owner. The main anti-deferral regimes that provide such exceptions are the controlled foreign corporation ("CFC") rules of subpart F[875] and the passive foreign investment company ("PFIC") rules.[876] A foreign tax credit generally is available to offset, in whole or in part, the U.S. tax owed on foreign-source income, whether the income is earned directly by the domestic corporation, repatriated as an actual dividend, or included in the domestic parent corporation's income under one of the anti-deferral regimes.[877]

2. Anti-deferral regimes

Subpart F

Subpart F,[878] applicable to CFCs and their shareholders, is the main anti-deferral regime of relevance to a U.S.-based multinational corporate group. A CFC generally is defined as any foreign corporation if U.S. persons own (directly, indirectly, or constructively) more than 50 percent of the corporation's stock (measured by vote or value), taking into account only those U.S. persons that are within the meaning of the term "United States shareholder," which refers only to those U.S. persons who own at least 10 percent of the stock (measured by vote only).[879]

Subpart F income

Under the subpart F rules, the United States generally taxes the 10-percent U.S. shareholders of a CFC on their pro rata shares of certain income of the CFC (referred to as "subpart F income"), without regard to whether the income is distributed to the shareholders.[880] In effect, the United States treats the 10-percent U.S. shareholders of a CFC as having received a current distribution of the corporation's subpart F income. With exceptions described below, subpart F income generally includes passive income and

[874] A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and foreign housing costs under section 911. For a description of this exclusion, see *Present Law and Issues in U.S. Taxation of Cross-Border Income* (JCX–42–11), September 6, 2011, p. 52.
[875] Secs. 951–964.
[876] Secs. 1291–1298.
[877] Secs. 901, 902, 960, 1293(f).
[878] Secs. 951–964.
[879] Secs. 951(b), 957, 958. The term "United States shareholder" is used interchangeably herein with "U.S. shareholder."
[880] Sec. 951(a).

other income that is readily movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income,[881] insurance income,[882] and certain income relating to international boycotts and other violations of public policy.[883]

Foreign base company income consists of foreign personal holding company income, which includes passive income such as dividends, interest, rents, and royalties, and a number of categories of income from business operations, including foreign base company sales income, foreign base company services income, and foreign base company oil-related income.[884]

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other country risks. Finally, special rules apply under subpart F with respect to related person insurance income[885] in order to address captive insurance companies.[886] Under these rules, the threshold for determining control is reduced to 25 percent, and any level of stock ownership by a U.S. person in such corporation is sufficient for the person to be treated as a U.S. shareholder.

Investments in U.S. property

The 10-percent U.S. shareholders of a CFC also are required to include currently in income for U.S. tax purposes their pro rata shares of the corporation's untaxed earnings invested in certain items of U.S. property.[887] This U.S. property generally includes tangible property located in the United States, stock of a U.S. corporation, an obligation of a U.S. person, and certain intangible assets, such as patents and copyrights, acquired or developed by the CFC for use in the United States.[888] There are specific exceptions to the general definition of U.S. property, including for bank deposits, certain export property, and certain trade or business obligations.[889] The inclusion rule for investment of earnings in U.S. property is intended to prevent taxpayers from avoiding U.S. tax on dividend repatriations by repatriating CFC earnings through nondividend payments, such as loans to U.S. persons.

Subpart F exceptions

Several exceptions to the broad definition of subpart F income permit continued deferral for income from certain transactions,

[881] Sec. 954.
[882] Sec. 953.
[883] Sec. 952(a)(3)–(5).
[884] Sec. 954.
[885] Sec. 953(c). Related person insurance income is defined for this purpose to mean any insurance income attributable to a policy of insurance or reinsurance with respect to which the primary insured is either a U.S. shareholder (within the meaning of the provision) in the foreign corporation receiving the income or a person related to such a shareholder.
[886] Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (JCS–10–87), May 4, 1987, p. 968.
[887] Secs. 951(a)(1)(B), 956.
[888] Sec. 956(c)(1).
[889] Sec. 956(c)(2).

dividends, interest and certain rents and royalties received by a CFC from a related corporation organized and operating in the same foreign country in which the CFC is organized.[890] The same-country exception is not available to the extent that the payments reduce the subpart F income of the payor. A second exception from foreign base company income and insurance income is available for any item of income received by a CFC if the taxpayer establishes that the income was subject to an effective foreign income tax rate greater than 90 percent of the maximum U.S. corporate income tax rate (that is, more than 90 percent of 35 percent, or 31.5 percent).[891]

A provision colloquially referred to as the "CFC look-through" rule excludes from foreign personal holding company income dividends, interest, rents, and royalties received or accrued by one CFC from a related CFC (with relation based on control) to the extent attributable or properly allocable to non-subpart-F income of the payor.[892] The look-through rule applies to taxable years of foreign corporations beginning before January 1, 2020, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.[893]

There is also an exclusion from subpart F income for certain income of a CFC that is derived in the active conduct of banking or financing business ("active financing income"), which applies to all taxable years of the foreign corporation beginning after December 31, 2014, and for taxable years of the shareholders that end during or within such taxable years of the corporation.[894] With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the active financing exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met.

In the case of a securities dealer, an exception from foreign personal holding company income applies to any interest or dividend (or certain equivalent amounts) from any transaction, including a hedging transaction or a transaction consisting of a deposit of collateral or margin, entered into in the ordinary course of the dealer's trade or business as a dealer in securities within the meaning

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[890] Sec. 954(c)(3).

[891] Sec. 954(b)(4).

[892] Sec. 954(c)(6).

[893] See section 144 of the Protecting Americans from Tax Hikes Act of 2015 (Division Q of Pub. L. No. 114–113), H.R. 2029 ("the PATH Act of 2015"), which extended section 954(c)(6) for five years. Congress has previously extended the application of section 954(c)(6) several times, most recently in the Tax Increase Prevention Act of 2014, Pub. L. No. 113–295; Pub. L. No. 107–147, sec. 614, 2002; Pub. L. No. 106–170, sec. 503, 1999; Pub. L. No. 105–277, 1998.

[894] Sec. 954(h). See section 128 of the PATH Act of 2015, which made the active financing exception permanent.

of section 475.[895] In the case of a QBU of the dealer, the income is required to be attributable to activities of the QBU in the country of incorporation, or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity. A coordination rule provides that, for securities dealers, this exception generally takes precedence over the exception for active financing income.

Income is treated as active financing income only if, among other requirements, it is derived by a CFC or by a QBU of that CFC. Certain activities conducted by persons related to the CFC or its QBU are treated as conducted directly by the CFC or QBU.[896] An activity qualifies under this rule if the activity is performed by employees of the related person and if the related person is an eligible CFC, the home country of which is the same as the home country of the related CFC or QBU; the activity is performed in the home country of the related person; and the related person receives arm's-length compensation that is treated as earned in the home country. Income from an activity qualifying under this rule is excluded from subpart F income so long as the other active financing requirements are satisfied.

Certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch or within the CFC's country of creation or organization are also excepted from foreign personal holding company income, provided that certain requirements are met. Further, additional exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions, including reserve requirements, are met.[897]

Exclusion of previously taxed earnings and profits

A 10-percent U.S. shareholder of a CFC may exclude from its income actual distributions of earnings and profits from the CFC that were previously included in the 10-percent U.S. shareholder's income under subpart F.[898] Any income inclusion (under section 956) resulting from investments in U.S. property may also be excluded from the 10-percent U.S. shareholder's income when such earnings are ultimately distributed.[899] Ordering rules provide that distributions from a CFC are treated as coming first out of earnings and profits of the CFC that have been previously taxed under subpart F, then out of other earnings and profits.[900]

[895] Sec. 954(c)(2)(C).
[896] Sec. 954(h)(3)(E).
[897] Subject to approval by the IRS, a taxpayer may establish that the reserve of a life insurance company for life insurance and annuity contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.
[898] Sec. 959(a)(1).
[899] Sec. 959(a)(2).
[900] Sec. 959(c).

Basis adjustments

In general, a 10-percent U.S. shareholder of a CFC receives a basis increase with respect to its stock in the CFC equal to the amount of the CFC's earnings that are included in the 10-percent U.S. shareholder's income under subpart F.[901] Similarly, a 10-percent U.S. shareholder of a CFC generally reduces its basis in the CFC's stock in an amount equal to any distributions that the 10-percent U.S. shareholder receives from the CFC that are excluded from its income as previously taxed under subpart F.[902]

Passive foreign investment companies

The Tax Reform Act of 1986[903] established the PFIC anti-deferral regime. A PFIC is generally defined as any foreign corporation if 75 percent or more of its gross income for the taxable year consists of passive income, or 50 percent or more of its assets consists of assets that produce, or are held for the production of, passive income.[904] Alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a PFIC, regardless of their percentage ownership in the company. One set of rules applies to PFICs that are qualified electing funds, under which electing U.S. shareholders currently include in gross income their respective shares of the company's earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received.[905] A second set of rules applies to PFICs that are not qualified electing funds, under which U.S. shareholders pay tax on certain income or gain realized through the company, plus an interest charge that is attributable to the value of deferral.[906] A third set of rules applies to PFIC stock that is marketable, under which electing U.S. shareholders currently take into account as income (or loss) the difference between the fair market value of the stock as of the close of the taxable year and their adjusted basis in such stock (subject to certain limitations), often referred to as "marking to market."[907] Under the PFIC regime, passive income is any income which is of a kind that would be foreign personal holding company income, including dividends, interest, royalties, rents, and certain gains on the sale or exchange of property, commodities, or foreign currency.

However, among other exceptions, passive income does not include any income derived in the active conduct of an insurance business by a corporation that is predominantly engaged in an insurance business and that would be subject to tax under subchapter L if it were a domestic corporation.[908] In applying the insurance exception, the IRS analyzes whether risks assumed under contracts issued by a foreign company organized as an insurer are truly insurance risks, whether the risks are limited under the

[901] Sec. 961(a).
[902] Sec. 961(b).
[903] Pub. L. No. 99–514.
[904] Sec. 1297.
[905] Secs. 1293–1295.
[906] Sec. 1291.
[907] Sec. 1296.
[908] Sec. 1297(b)(2)(B).

terms of the contracts, and the status of the company as an insurance company.[909]

Other anti-deferral rules

The subpart F and PFIC rules are not the only anti-deferral regimes. Other rules that impose current U.S. taxation on income earned through corporations include the accumulated earnings tax rules[910] and the personal holding company rules.

Rules for coordination among the anti-deferral regimes are provided to prevent U.S. persons from being subject to U.S. tax on the same item of income under multiple regimes. For example, a corporation generally is not treated as a PFIC with respect to a particular shareholder if the corporation is also a CFC and the shareholder is a 10-percent U.S. shareholder. Thus, subpart F is allowed to trump the PFIC rules.

3. Foreign tax credit

Subject to certain limitations, U.S. citizens, resident individuals, and domestic corporations are allowed to claim credit for foreign income taxes they pay. A domestic corporation that owns at least 10 percent of the voting stock of a foreign corporation is allowed a "deemed-paid" credit for foreign income taxes paid by the foreign corporation that the domestic corporation is deemed to have paid when the related income is distributed as a dividend or is included in the domestic corporation's income under the anti-deferral rules.[911]

The foreign tax credit generally is limited to a taxpayer's U.S. tax liability on its foreign-source taxable income (as determined under U.S. tax accounting principles). This limit is intended to ensure that the credit serves its purpose of mitigating double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income.[912] The limit is computed by multiplying a taxpayer's total U.S. tax liability for the year by the ratio of the taxpayer's foreign-source taxable income for the year to the taxpayer's total taxable income for the year. If the total amount of foreign income taxes paid and deemed paid for the year exceeds the taxpayer's foreign tax credit limitation for the year, the taxpayer may carry back the excess foreign taxes to the previous year or carry forward the excess taxes to one of the succeeding 10 years.[913]

The computation of the foreign tax credit limitation requires a taxpayer to determine the amount of its taxable income from foreign sources in each limitation category (described below) by allocating and apportioning deductions between U.S.-source gross income, on the one hand, and foreign-source gross income in each limitation category, on the other. In general, deductions are allocated and apportioned to the gross income to which the deductions factually relate.[914] However, subject to certain exceptions, deductions for interest expense and research and experimental expenses

[909] Notice 2003–34, 2003–C.B. 1 990, June 9, 2003. See also, Prop. Treas. Reg. sec. 1.1297–4, 26 CFR Part 1, REG–108214–15, April 24, 2015.
[910] Secs. 531–537.
[911] Secs. 901, 902, 960, 1291(g).
[912] Secs. 901, 904.
[913] Sec. 904(c).
[914] Treas. Reg. sec. 1.861–8(b), Temp. Treas. Reg. sec. 1.861–8T(c).

are apportioned based on taxpayer ratios.[915] In the case of interest expense, this ratio is the ratio of the corporation's foreign or domestic (as applicable) assets to its worldwide assets. In the case of research and experimental expenses, the apportionment ratio is based on either sales or gross income. All members of an affiliated group of corporations generally are treated as a single corporation for purposes of determining the apportionment ratios.[916]

The term "affiliated group" is determined generally by reference to the rules for determining whether corporations are eligible to file consolidated returns.[917] These rules exclude foreign corporations from an affiliated group.[918] Interest expense allocation rules permitting a U.S. affiliated group to apportion the interest expense of the members of the U.S. affiliated group on a worldwide-group basis were modified in 2004, and initially effective for taxable years beginning after December 31, 2008.[919] The effective date of the modified rules has been delayed to January 1, 2021.[920] A result of this rule is that interest expense of foreign members of a U.S. affiliated group is taken into account in determining whether a portion of the interest expense of the domestic members of the group must be allocated to foreign-source income. An allocation to foreign-source income generally is required only if, in broad terms, the domestic members of the group are more highly leveraged than is the entire worldwide group. The new rules are generally expected to reduce the amount of the U.S. group's interest expense that is allocated to foreign-source income.

The foreign tax credit limitation is applied separately to passive category income and to general category income.[921] Passive category income includes passive income, such as portfolio interest and dividend income, and certain specified types of income. All other income is in the general category. Passive income is treated as general category income if it is earned by a qualifying financial services entity. Passive income is also treated as general category income if it is highly taxed (that is, if the foreign tax rate is determined to exceed the highest rate of tax specified in Code section 1 or 11, as applicable). Dividends (and subpart F inclusions), interest, rents, and royalties received by a 10-percent U.S. shareholder from a CFC are assigned to a separate limitation category by reference to the category of income out of which the dividends or other payments were made.[922] Dividends received by a 10-percent cor-

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[915] Temp. Treas. Reg. sec. 1.861–9T, Treas. Reg. sec. 1.861–17.

[916] Sec. 864(e)(1), (6); Temp. Treas. Reg. sec. 1.861–14T(e)(2).

[917] Secs. 864(e)(5), 1504.

[918] Sec. 1504(b)(3).

[919] Sec. 864(f); "American Jobs Creation Act of 2004" ("AJCA"), Pub. L. 108–357, sec. 401(a).

[920] Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, sec. 551(a).

[921] Sec. 904(d). AJCA generally reduced the number of income categories from nine to two, effective for tax years beginning in 2006. Before AJCA, the foreign tax credit limitation was applied separately to the following categories of income: (1) passive income, (2) high withholding tax interest, (3) financial services income, (4) shipping income, (5) certain dividends received from noncontrolled section 902 foreign corporations (also known as "10/50 companies"), (6) certain dividends from a domestic international sales corporation or former domestic international sales corporation, (7) taxable income attributable to certain foreign trade income, (8) certain distributions from a foreign sales corporation or former foreign sales corporation, and (9) any other income not described in items (1) through (8) (so-called "general basket" income). A number of other provisions of the Code, including several enacted in 2010 as part of Pub. L. No. 111–226, create additional separate categories in specific circumstances or limit the availability of the foreign tax credit in other ways. See, *e.g.*, secs. 865(h), 901(j), 904(d)(6), 904(h)(10).

[922] Sec. 904(d)(3). The subpart F rules applicable to CFCs and their 10-percent U.S. shareholders are described below.

porate shareholder of a foreign corporation that is not a CFC are also categorized on a look-through basis.[923]

Special rules apply to the allocation of income and losses from foreign and U.S. sources within each category of income.[924] Foreign losses from one category will first be used to offset income from foreign sources of other categories. If there remains an overall foreign loss, it will be deducted against income from U.S. sources. The same principle applies to losses from U.S. sources. In subsequent years, the losses that were deducted against another category or source of income will be recaptured. That is, an equal amount of income from the same category or source that generated a loss in the prior year will be recharacterized as income from the other category or source against which the loss was deducted. Up to 50 percent of income from one source in any subsequent year will be recharacterized as income from the other source, whereas foreign-source income in a particular category can be fully recharacterized as income in another category until the losses from prior years are fully recaptured.[925]

In addition to the foreign tax credit limitation just described, a taxpayer's ability to claim a foreign tax credit may be further limited by a matching rule that prevents the separation of creditable foreign taxes from the associated foreign income. Under this rule, a foreign tax generally is not taken into account for U.S. tax purposes, and thus no foreign tax credit is available with respect to that foreign tax, until the taxable year in which the related income is taken into account for U.S. tax purposes.[926]

4. Special rules

Dual consolidated loss rules

Under the rules applicable to corporations filing consolidated returns, a dual consolidated loss ("DCL") is any net operating loss of a domestic corporation if the corporation is subject to an income tax of a foreign country without regard to whether such income is from sources in or outside of such foreign country, or if the corporation is subject to such a tax on a residence basis (a "dual resident corporation").[927] A DCL generally cannot be used to reduce the taxable income of any member of the corporation's affiliated group. Losses of a separate unit of a domestic corporation (a foreign branch or an interest in a hybrid entity owned by the corporation) are subject to this limitation in the same manner as if the unit were a wholly owned subsidiary of such corporation. An exemption is available under Treasury regulations in the case of DCLs for which a domestic use election (that is, an election to use the loss only for domestic, and not foreign, tax purposes) has been made.[928] Recapture is required, however, upon the occurrence of certain triggering events, including the conversion of a separate unit to a foreign corporation and the transfer of 50 percent or more of the assets of a separate unit within a twelve-month period.[929]

[923] Sec. 904(d)(4).
[924] Secs. 904(f), (g).
[925] Secs. 904(f)(1), (g)(1).
[926] Sec. 909.
[927] Sec. 1503(d).
[928] Treas. Reg. sec. 1.1503(d)–6(d).
[929] See Treas. Reg. sec. 1.1503(d)–6(e)(1).

Temporary dividends-received deduction for repatriated foreign earnings

AJCA section 421 added to the Code section 965, a temporary provision intended to encourage U.S. multinational companies to repatriate foreign earnings. Under section 965, for one taxable year certain dividends received by a U.S. corporation from its CFCs were eligible for an 85-percent dividends-received deduction. At the taxpayer's election, this deduction was available for dividends received either during the taxpayer's first taxable year beginning on or after October 22, 2004, or during the taxpayer's last taxable year beginning before such date.

The temporary deduction was subject to a number of general limitations. First, it applied only to cash repatriations generally in excess of the taxpayer's average repatriation level calculated for a three-year base period preceding the year of the deduction. Second, the amount of dividends eligible for the deduction was generally limited to the amount of earnings shown as permanently invested outside the United States on the taxpayer's recent audited financial statements. Third, to qualify for the deduction, dividends were required to be invested in the United States according to a domestic reinvestment plan approved by the taxpayer's senior management and board of directors.[930]

No foreign tax credit (or deduction) was allowed for foreign taxes attributable to the deductible portion of any dividend.[931] For this purpose, the taxpayer was permitted to specifically identify which dividends were treated as carrying the deduction and which dividends were not. In other words, the taxpayer was allowed to choose which of its dividends were treated as meeting the base-period repatriation level (and thus carry foreign tax credits, to the extent otherwise allowable), and which of its dividends were treated as part of the excess eligible for the deduction (and thus subject to proportional disallowance of any associated foreign tax credits).[932] Deductions were disallowed for expenses that were directly allocable to the deductible portion of any dividend.[933]

Domestic international sales corporations

A domestic international sales corporations ("DISC") is a domestic corporation that satisfies the following conditions: 95 percent of its gross receipts must be qualified export receipts; 95 percent of the sum of the adjusted bases of all its assets must be attributable to the sum of the adjusted bases of qualified export assets; the corporation must have no more than one class of stock; the par or stated value of the outstanding stock must be at least $2,500 on each day of the taxable year; and an election must be in effect to

[930] Section 965(b)(4). The plan was required to provide for the reinvestment of the repatriated dividends in the United States, including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, and the financial stabilization of the corporation for the purposes of job retention or creation.

[931] Sec. 965(d)(1).

[932] Accordingly, taxpayers generally were expected to pay regular dividends out of high-taxed CFC earnings (thereby generating deemed-paid credits available to offset foreign-source income) and section 965 dividends out of low-taxed CFC earnings (thereby availing themselves of the 85-percent deduction).

[933] Sec. 965(d)(2).

be taxed as a DISC.[934] In general, a DISC is not subject to corporate-level tax and offers limited deferral of tax liability to its shareholders.[935] DISC income attributable to a maximum of $10 million annually of qualified export receipts is generally exempt from income tax at both the corporate and shareholder level. Shareholders must pay interest to account for the benefit of deferring the tax liability on undistributed DISC income related to this $10 million maximum annual amount.[936] Such entities are also referred to as interest charge DISCs, or IC–DISCs. Shareholders of a DISC are deemed to receive a dividend out of current earnings and profits from qualified export receipts in excess of $10 million.[937] Gain on the sale of DISC stock is treated as a dividend to the extent of accumulated DISC income.[938] The shareholders of a corporation which is not a DISC, but was a DISC in a previous taxable year, and which has previously taxed income or accumulated DISC income, are also required to pay interest on the deferral benefit, and gain on the sale or exchange of stock in such corporation is treated as a dividend.

TAXATION OF FOREIGN INCOME AND FOREIGN PERSONS

A. ESTABLISHMENT OF PARTICIPATION EXEMPTION SYSTEM FOR TAXATION OF FOREIGN INCOME

1. Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations (sec. 4001 of the bill and new sec. 245A of the Code)

REASONS FOR CHANGE

The Committee believes that the current tax system puts American workers and companies at a severe disadvantage to foreign workers and companies. This is primarily because the United States is one of the few industrialized countries with a worldwide system of taxation and has the highest corporate tax rate among OECD member countries. The worldwide system of taxation with deferral provides perverse incentives to keep funds offshore because dividends from foreign subsidiaries are not taxed until repatriated to the United States. The Committee believes that a territorial system with appropriate anti-base erosion safeguards, combined with a lower corporate tax rate, will make American workers and companies competitive again, and also will remove tax-driven incentives to keep funds offshore.

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[934] Secs. 992(a) and (b). If a corporation fails to satisfy either or both of the 95-percent tests, it is deemed to satisfy such tests if it makes a pro rata distribution of its gross receipts which are not qualified export receipts and the fair market value of its assets which are not qualified export assets. Sec. 992(c).

[935] Sec. 991. Prior to the 1984 Revenue Act (Pub. L. 98–369), DISCs were eligible for more generous tax benefits that were eliminated in favor of the since-repealed foreign sales corporation regime ("FSC"). An overview of the history of the DISCs and FSCs regimes is provided in Joseph Isenbergh, Vol. 3 U.S. *Taxation of Foreign Persons and Foreign Income*, Para. 81. (Fourth Ed. 2016).

[936] The rate is the average of one-year constant maturity Treasury yields. The deferral benefit is the excess of the amount of tax for which the shareholder would be liable if deferred DISC income were included as ordinary income over the actual tax liability of such shareholder. Sec. 995(f).

[937] The amount of the deemed distribution is the sum of several items, including qualified export receipts in excess of $10 million. See sec. 955(b).

[938] Sec. 995(c).

EXPLANATION OF PROVISION

In general

The provision generally establishes a participation exemption system for foreign income. This exemption is provided for by means of a 100-percent deduction for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations by domestic corporations that are United States shareholders of those foreign corporations within the meaning of section 951(b) (referred to here as "participation DRD").[939]

A specified 10-percent owned foreign corporation is any foreign corporation with respect to which any domestic corporation is a United States shareholder. The phrase does not include a passive foreign investment company within the meaning of subpart D of part VI of subchapter P.

The term "dividend received" is intended to be interpreted broadly, consistently with the meaning of the phrases "amount received as dividends" and "dividends received" under sections 243 and 245, respectively.[940] Under proposed section 245A(e), the Secretary of the Treasury may prescribe such regulations or other guidance as may be necessary or appropriate to carry out the rules of section 245A, including clarifying the intended broad scope of the term "dividend received."

For example, if a domestic corporation indirectly owns stock of a foreign corporation through a foreign partnership and the domestic corporation would qualify for the participation DRD with respect to dividends from the foreign corporation if the domestic corporation owned such stock directly, the domestic corporation would be allowed a participation DRD with respect to its distributive share of the partnership's dividend from the foreign corporation.

Foreign-source portion of a dividend

The participation DRD is available only for the foreign-source portion of dividends received from specified 10-percent owned foreign corporations. The foreign-source portion of any dividend is the amount that bears the same ratio to the dividend as the specified foreign corporation's post-1986 undistributed foreign earnings bears to the corporation's total post-1986 undistributed earnings. Post-1986 undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign corporation accumulated in taxable years beginning after December 31, 1986, as of the close of the taxable year of the foreign corporation in which the dividend is distributed and not reduced by dividends[941] distributed during that year. Post-1986 undistributed foreign earnings are, in general, the portion of post-1986 undistributed earnings that is not attributable to post-1986 undistributed U.S. earnings. Post-1986 undistributed U.S. earnings are, in general, undistributed earnings attributable to: (a) the corporation's income that is effectively con-

[939] Under section 951(b), a domestic corporation is a United States shareholder of a foreign corporation if it owns, within the meaning of section 958(a), or is considered as owning by applying the rules of section 958(b), 10 percent or more of the voting stock of the foreign corporation.

[940] Consequently, for example, gain included in gross income as a dividend under section 1248(a) or 964(e) would constitute a dividend received for which the deduction under section 245A may be available.

[941] Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.

nected with the conduct of a trade or business within the United States, or (b) any dividend received (directly or through a wholly owned foreign corporation) from an 80-percent-owned (by vote or value) domestic corporation.

Rules similar to the rules described above apply when a dividend is paid out of earnings and profits of a specified 10-percent owned foreign corporation accumulated in taxable years beginning before January 1, 1987. As a consequence, the participation exemption system is available for both post-1986 and pre-1987 foreign earnings. An ordering rule provides that dividends are treated as first being paid out of post-1986 undistributed earnings to the extent of those earnings.

An additional rule provides for the treatment of distributions of a specified 10-percent owned foreign corporation in excess of undistributed earnings. Under section 316(a)(2), a distribution of earnings and profits of a corporation in the taxable year of the distribution is treated as a dividend even if the distribution exceeds accumulated earnings and profits.[942] The determination of the foreign-source portion of such a distribution is calculated in a similar manner as for other types of dividends.

Foreign tax credit disallowance; foreign tax credit limitation

No foreign tax credit or deduction is allowed for any taxes (including withholding taxes) paid or accrued with respect to a dividend that qualifies for the participation DRD.

For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a United States shareholder of a specified 10-percent owned foreign corporation must compute its foreign-source taxable income (and entire taxable income) by disregarding the foreign-source portion of any dividend received from that foreign corporation for which the participation DRD is taken, as well as and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Six-month holding period requirement

A domestic corporation is not permitted a participation DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 180 days or less during the 361-day period beginning on the date that is 180 days before the date on which the share becomes ex-dividend with respect to the dividend. For this purpose, a domestic corporation is treated as holding a share of stock for any period only if the corporation is a specified 10-percent owned foreign corporation and the taxpayer is a United States shareholder with respect to such corporation during that period.

EFFECTIVE DATE

The provision applies to distributions made (and for purposes of determining a taxpayer's foreign tax credit limitation under section 904, deductions in taxable years beginning) after December 31, 2017.

[942] Called a "nimble dividend." *See,* Boris I. Bittker and James S. Eustice, *Federal Income Taxation of Corporations and Shareholders,* (7th ed. 2016) para. 8–12.

2. Application of participation exemption to investments in United States property (sec. 4002 of the bill sec. 956 of the Code)

REASONS FOR CHANGE

The Committee believes that including amounts that a CFC invests in United States property in a domestic corporate shareholder's gross income would be the wrong result under a participation exemption system, when the CFC could otherwise pay a dividend or distribute property to the domestic corporate shareholder in a manner that would be tax-free. The Committee further believes that retention of such a rule would needlessly discourage investment in the United States. However, because the participation exemption does not extend to individuals, section 956 should remain in effect with respect to individuals who are United States shareholders of CFCs.

EXPLANATION OF PROVISION

Under the provision, the amount determined under section 956 (relating to CFC investments in United States property) with respect to a domestic corporation is zero. A similar rule is intended for domestic corporations that own a CFC through a domestic partnership. The provision includes a specific grant of authority to the Secretary to issue regulations to effect that intent.

EFFECTIVE DATE

The provision applies to taxable years of foreign corporations beginning after December 31, 2017.

3. Limitation on losses with respect to specified 10-percent owned foreign corporations (sec. 4003 of the bill secs. 367(a)(3)(C) and 961 of the Code, and new sec. 91 of the Code)

REASONS FOR CHANGE

The Committee is concerned that a participation exemption system could provide inappropriate double benefits in certain circumstances. In particular, a distribution from a foreign subsidiary that is eligible for a participation DRD would reduce the value of the foreign subsidiary, thereby reducing any built-in gain or increasing any built-in loss in the shareholder's stock of the subsidiary. Reducing gain in this manner is consistent with the application of section 1248(a) (or section 964(e)) to recharacterize gain as a dividend for which a participation DRD may be permitted. Increasing loss in this manner, however, creates an inappropriate and double U.S. tax benefit for receiving a tax-free distribution from a foreign subsidiary.

Separately, the Committee is concerned that taxpayers may wish to arbitrage the application of the participation exemption system to foreign subsidiaries but not foreign branches. Specifically, a taxpayer may deduct losses from a foreign branch operation against U.S. taxable income and then incorporate that branch once it becomes profitable. Present law provides an array of loss recapture rules to address such a fact pattern,[943] but those rules generally

[943] See, e.g., secs. 367(a)(3)(C), 904(f)(3), 1503(d).

rely on the worldwide system of taxation to recapture losses in excess of built-in gains by taxing future earnings when repatriated. Instead of only recapturing such losses upon later repatriation of earning, the Committee wishes to recapture the U.S. tax benefits of these losses immediately upon the incorporation of a foreign branch that has generated losses. This is so that the repatriation of foreign earnings will not carry negative tax consequences thereby discouraging such repatriation, which is one of the reasons for moving to a participation exemption system of taxation.

EXPLANATION OF PROVISION

Reduction in basis of certain foreign stock

Under the provision, solely for the purpose of determining a loss, a domestic corporate shareholder's adjusted basis in the stock of a specified 10-percent owned foreign corporation (as defined in new section 245A) is reduced by an amount equal to the portion of any dividend received with respect to such stock from such foreign corporation that was not taxed by reason of a dividends received deduction allowable under section 245A in any taxable year of such domestic corporation. This rule applies in coordination with section 1059, such that any reduction in basis required pursuant to this provision will be disregarded, to the extent the basis in the 10-percent owned foreign corporation's stock has already been reduced pursuant to section 1059.

Inclusion of transferred loss amount in certain assets transfers

Under the provision, if a domestic corporation transfers substantially all of the assets of a foreign branch (within the meaning of section 367(a)(3)(C)) to a foreign corporation which, after such transfer, is a specified 10-percent owned foreign corporation with respect to which the domestic corporation is a United States shareholder, the domestic corporation includes in gross income an amount equal to the transferred loss amount, subject to certain limitations.

The transferred loss amount is the excess of: (1) losses incurred by the foreign branch after December 31, 2017 for which a deduction was allowed to the domestic corporation, over (2) the sum of taxable income earned by the foreign branch and gain recognized by reason of an overall foreign loss recapture arising out of disposition of assets on account of the underlying transfer. For the purposes of (2), only taxable income of the foreign branch in taxable years after the loss is incurred through the close of the taxable year of the transfer is included.

For transfers not covered by section 367(a)(3)(C), the transferred loss amount is reduced by the amount of gain recognized by the domestic corporation on the transfer (other than gains recognized by reason of overall foreign loss recapture). For transfers covered by section 367(a)(3)(C), the transferred loss amount is reduced by the amount of gain recognized by reason of such subparagraph.

Amounts included in gross income by reason of the provision or by reason of section 367(a)(3)(C) are treated as derived from sources within the United States.

The provision provides authority for the Secretary of the Treasury to prescribe regulations or other guidance for proper adjustments to the adjusted basis of the specified 10 percent owned foreign corporation to which the transfer is made, and to the adjusted basis of the property transferred, to reflect amounts included in gross income under the provision.

EFFECTIVE DATE

The provision relating to reduction of basis in certain foreign stock for the purposes of determining a loss is effective for distributions made after December 31, 2017.

The provision relating to transfer of loss amounts from foreign branches to certain foreign corporations is effective for transfers after December 31, 2017.

4. Treatment of deferred foreign income upon transition to participation exemption system of taxation (sec. 4004 of the bill and secs. 78, 904, 907, and 965 of the Code)

REASONS FOR CHANGE

In transitioning to a new participation exemption system, the Committee seeks to enhance both the global competitiveness of U.S. businesses and to encourage investment in the United States. The Committee believes that many domestic companies were reluctant to reinvest foreign earnings in the United States, when doing so would subject those earnings to high rates of corporate income tax rates. Accordingly, the Committee is aware that such companies have accumulated significant untaxed and undistributed foreign earnings as a result.

The Committee is also aware that such companies are eligible for a 100-percent dividend-received deduction with respect to any distributions made under the new participation exemption system. To avoid a potential windfall for corporations that deferred income, and to ensure that all distributions from foreign subsidiaries are treated in the same manner under the participation exemption system, the Committee believes that it is appropriate to tax such earnings as if they had been repatriated under present law, but at a reduced rate.

The Committee believes the tax on accumulated foreign earnings should apply without requiring an actual distribution of earnings, and further believes that the tax rate should take into account the liquidity of the accumulated earnings. Accordingly, the provision establishes a bifurcated rate, i.e., 14 percent for earnings held in liquid form and 7 percent for accumulated foreign earnings that have been reinvested in the foreign subsidiary's business. Finally, the Committee has provided procedures for payment and collection of the transition tax that mitigate the burden on taxpayers.

EXPLANATION OF PROVISION

In general

The provision generally requires that, for the last taxable year beginning before January 1, 2018, a U.S. shareholders of any CFC or other foreign corporation that is at least 10-percent U.S.-owned but not controlled (other than a PFIC) must include in income its pro rata share of the accumulated post-1986 deferred foreign income which was not previously taxed. A portion of that pro rata share of deferred foreign income is deductible; the amount deductible varies depending upon whether the deferred foreign income is held in the form of liquid or illiquid assets. The deduction results in a reduced rate of tax of 14 percent for the included deferred foreign income held in liquid form and 7 percent for the remaining deferred foreign income. A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The increased tax liability generally may be paid over an eight-year period.

Subpart F inclusion of deferred foreign income

The mechanism for the mandatory inclusion of pre-effective date foreign earnings is subpart F. The provision provides that the subpart F income of a specified foreign corporation is increased for the last taxable year[944] that begins before January 1, 2018, by its accumulated post-1986 deferred foreign income. In contrast to the participation exemption deduction available only to domestic corporations that are U.S. shareholders under subpart F, the transition rule plies to all U.S. shareholders[945] of a specified foreign corporation. A specified foreign corporation means (1) a CFC or (2) any foreign corporation in which a domestic corporation is a U.S. shareholder (determined without regard to the special attribution rules of section 958(b)(4)), other than a PFIC that is not a CFC.[946] A specified foreign corporation that has deferred foreign income is a deferred foreign income corporation. Consistent with the general operation of subpart F, each U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the foreign corporation's subpart F income attributable to its accumulated deferred foreign income.[947]

Accumulated post-1986 deferred foreign income

Accumulated post-1986 deferred foreign income of a specified foreign corporation that is the subject to mandatory inclusion under this provision is the greater of the accumulated post-1986 deferred foreign income determined as of November 2, 2017 (the date of introduction of the bill) or as of December 31, 2017. The includible portion of the accumulated post-1986 deferred foreign income is all post-1986 earnings and profits ("E&P") that are not (1) attributable to income that is effectively connected with the conduct of a trade or business in the United States and thus subject to current U.S. income tax, or (2) when distributed, excludible from the gross income of a U.S. shareholder as previously taxed income under section 959.

Post-1986 earnings and profits are those earnings that accumulated in taxable years beginning after 1986, computed in accordance with sections 964(a) and 986, even if arising from periods during which the U.S. shareholder did not own stock of the foreign corporation. Post-1986 earnings are not reduced by dividends during

[944] Foreign corporations no longer in existence and for which there is no taxable year beginning or ending in 2017 are not within the scope of this provision.

[545] Sec. 951(b), which defines United States shareholder as any U.S. person that owns 10 percent or more of the voting classes of stock of a foreign corporation.

[546] Taxation of income earned by PFICs remains subject to the antideferral PFIC regime and dividends received from non-CFC PFICs are ineligible for the dividend received deduction under new section 245A.

[547] For purposes of taking into account its subpart F income under this rule, a noncontrolled 10/50 corporation is treated as a CFC.

the taxable year in which measurement occurs. Such earnings are increased by the amount of qualified deficits [948] that arose in a taxable year beginning before January 1, 2018, if such deficit is also treated as a qualified deficit for purposes of taxable years beginning after December 31, 2017. Finally, the post-1986 earnings and profits are determined by reference to the foreign corporation's total earnings and profits, irrespective of the foreign tax credit separate category limitations.[949]

The Secretary may prescribe regulations or other guidance regarding the treatment of accumulated post-1986 foreign deferred income of specified foreign corporations that have shareholders who are not U.S. shareholders. Such rules may also include rules that are appropriate to implement the intent of the revised section 965 and the use of the date of introduction as one of the measurement dates in order to establish a floor for determining the post-1986 deferred foreign earnings and profits. For example, guidance may address the extent to which retroactive effective dates selected in entity classification elections filed after introduction of the bill will be permitted.[950]

Reductions of amounts included in income of U.S. shareholder of foreign corporations with deficits in E&P

The income inclusion required of a U.S. shareholder under this transition rule is reduced by the portion of aggregate foreign earnings and profits deficit allocated to that person by reason of that person's interest in one or more E&P deficit foreign corporations. An E&P deficit foreign corporation is defined as any specified foreign corporation owned by the U.S. shareholder as of the date on which accumulated earnings and profits are measure for that corporation (November 2, 2017 or December 31, 2017, as the case may be) and which also has a deficit in post-1986 earnings and profits as of that date. Accordingly, the deficits of a foreign subsidiary that accumulated prior to its acquisition by the U.S. shareholder may be taken into account in determining the aggregate foreign earnings and profits deficit of a U.S. shareholder.

The U.S. shareholder aggregates its pro rata share in the foreign E&P deficits of each such company and allocates such aggregate amount among the deferred foreign income corporations in which the shareholder is a U.S. shareholder. The aggregate foreign E&P deficit is allocable to a specified foreign corporation in the same ratio as the U.S. shareholder's pro rata share of post-1986 deferred income in that corporation bears to the U.S. shareholder's pro rata share of accumulated post-1986 deferred foreign income from all deferred income companies of such shareholder.

To illustrate the ratio, assume that Z, a domestic corporation, is a U.S. shareholder with respect to each of four specified foreign

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[948] Sec. 952(c)(1)(B)(ii).

[949] For example, assume that a foreign corporation organized after December 31, 1986 has $100 of accumulated earnings and profits as of November 1, 2017, and December 31, 2017 (determined without diminution by reason of dividends distributed during the taxable year and after any increase for qualified deficits), which consist of $120 general limitation earnings and profits and a $20 passive limitation deficit, the foreign corporation's post-1986 earnings and profits would be $100, even if the $20 passive limitation deficit was a hovering deficit described in Treas. Reg. sec. 1.367(b)-17(d)(2). Foreign income taxes related to the hovering deficit, however, would not be deemed paid by the U.S. shareholder recognizing an incremental income inclusion. The same would be true of a hovering deficit in the general limitation category.

[950] See Treas, Reg, 301.7701–3(c), under which an election may specify an effective date up to 75 days prior to the date on which the election is filed.

corporations, two of which are E&P deficit foreign corporations. Assume further the foreign companies have the following accumulated post-1986 deferred foreign income or foreign E&P deficits as of November 2, 2017 and December 31, 2017:

Example

Specified Foreign Corp.	Percentage Owned	Post-1986 profit/deficit USD	Pro Rata Share
A	60%	($1,000)	($600)
B	10%	($200)	($20)
C	$2,000	$1,400	70%
D	100%	$1,000	$1,000

The aggregate foreign E&P deficit of the U.S. shareholder is ($620), and the aggregate share of accumulated post-1986 deferred foreign income is $2,400. Thus, the portion of the aggregate foreign E&P deficit allocable to Corporation C is ($362), that is, ($620) × 1400/2400. The remainder of the aggregate foreign E&P deficit is allocable to Corporation D. The U.S. shareholder has a net surplus of E&P in the amount of $1,780.

The provision also permits intragroup netting among U.S. shareholders in an affiliated group in which there is at least one U.S. shareholder with a net E&P surplus and another with a net E&P deficit. The net E&P surplus shareholder may reduce its net surplus by the shareholder's applicable share of aggregate unused E&P deficit, based on the group's ownership percentage of the members. For example, assume that a U.S. corporation has two domestic subsidiaries, X and Y, each of which it owns 100 percent and 80 percent, respectively. If X has a $1,000 net E&P surplus, and Y has $1,000 net E&P deficit, X is an E&P net surplus shareholder, and Y is an E&P net deficit shareholder. The net E&P surplus of X is reduced by the net E&P deficit of Y to the extent of the group's ownership percentage in Y, which is 80-percent. The remaining net E&P deficit of Y is unused. If the U.S. shareholder Z is also a wholly owned subsidiary of the same U.S. parent as X and Y, the group ownership percentage of Y is unchanged, and the surpluses of X and Z are reduced ratably by 800 of the net E&P deficit of Y.

Participation exemption applied to accumulated post-1986 deferred foreign income

A U.S. shareholder of a specified foreign corporation is allowed a deduction of a portion of the increased subpart F income attributable to the inclusion of pre-effective date deferred foreign income. The amount of the deduction is the sum of the 14-percent rate equivalent percentage of the inclusion amount that is the shareholder's aggregate cash position and the 7 percent rate equivalent percentage of the portion of the inclusion that exceeds the aggregate cash position. By stating the permitted deduction in the form of a tax rate equivalent percentage, the provision ensures that all pre-effective date accumulated post-1986 deferred foreign income is subject to either a 7-percent or 14-percent rate of tax, depending on the underlying assets as of the measurement date, without regard to the corporate tax rate that may be in effect at the time of the inclusion. For example, corporate taxpayers that use a fiscal year as the taxable year may report the increased subpart F income in a taxable year for which a reduced corporate tax rate would otherwise apply (on a pro-rated basis under section 15), but the allowable deduction would be reduced such that the rate of U.S. tax on the income inclusion would be 7 or 14 percent.

Aggregate cash position

The aggregate cash position of a U.S. shareholder is the average of the shareholder's pro rata share of the cash position of each specified foreign corporation with respect to which that shareholder is a U.S. shareholder on each of three dates: date of introduction (November 2, 2017) and the last day of the two most recent taxable years ending before the date of introduction. Appropriate adjustments are made if a specified foreign corporation is not in existence on one or more of those dates. By using a three-year average as the aggregate cash position for a U.S. shareholders, the effect of unusual or anomalous transactions is muted.

For purposes of this computation, the cash position of certain non-corporate entities that would be treated as specified foreign corporations if they were foreign corporations is also included. The cash position of an entity consists of all cash, net accounts receivables, and the fair market value of similarly liquid assets, specifically including personal property that is actively traded on an established financial market, government securities, certificates of deposit, commercial paper, foreign currency, and short-term obligations. In addition, the Secretary may identify other assets that are economically equivalent to the enumerated assets that are treated as cash.

Certain reductions from the aggregate cash position are specified in the provision. First, rules are provided to avoid the double counting of cash positions of specified foreign corporations in an affiliated group, while ensuring that all of the cash position is taken into account. Second, regardless of the form in which a specified foreign corporation holds earnings, to the extent the earnings constitute blocked income that could not be distributed by the corporation due to local jurisdiction restrictions,[951] such earnings are not included in the cash position of that specified foreign corporation. The blocked income remains within the scope of the accumulated post-1986 deferred foreign income that is subject to inclusion under this provision.

In addition to the authority to identify other assets that are subject to the cash position determination by regulation, the provision also authorizes the Secretary to disregard transactions that are determined to have the principal purpose of reducing the aggregate foreign cash position.

Foreign tax credits reduced

A portion of foreign income taxes deemed paid or accrued with respect to the increased subpart F income attributable to the inclusion of pre-effective date deferred foreign income is not creditable against the Federal income tax attributable to the inclusion, nor are they deductible. The disallowed portion of foreign tax credits is 60 percent of foreign taxes paid attributable to the portion of the inclusion attributable to the aggregate cash position plus 80 per-

[951] 1ASec. 964(b) and regulations thereunder.

cent of foreign taxes paid attributable to the remaining portion of the section 965 inclusion.[952]

The provision coordinates the disallowance of foreign tax credits described above with the requirement[953] that a domestic corporate shareholder is deemed to receive a dividend in an amount equal to foreign taxes it is deemed to have paid and for which it claimed a credit. Under the coordination rule, the foreign taxes treated as paid or accrued by a domestic corporation as a result of the inclusion are limited to those taxes in proportion to the taxable portion of the section 965 inclusion. The gross-up amount equals the total foreign income taxes multiplied by a fraction, the numerator of which is taxable portion of the increased subpart F income under this provision and the denominator of which is the total increase in subpart F income under this provision.

The amount of deferred foreign income required to be included in subpart F income under this provision is disregarded for purposes of determining the amount of income from foreign sources and the combined foreign oil and gas income that a U.S. shareholder has for purposes of the recapture rules applicable to overall foreign losses, separate limitation losses, and foreign oil and gas losses under sections 904(f)(1) and 907(c)(4).

The foreign income taxes deemed paid with respect to the inclusion required by the provision and for which no credit is allowed in the year of inclusion by reason of section 904 limitations (e.g., because part or all of the inclusion required by the provision is offset by a net operating loss deduction) are eligible for a special 20 year carry-forward period, rather than the otherwise applicable 10 year carry-forward period.

Installment payments

A U.S. shareholder may elect to pay the net tax liability resulting from the mandatory inclusion of pre-effective-date undistributed CFC earnings in eight equal installments. The net tax liability that may be paid in installments is the excess of the U.S. shareholder's net income tax for the taxable year in which the pre-effective-date undistributed CFC earnings are included in income over the taxpayer's net income tax for that year determined without regard to the inclusion. Net income tax means net income tax as defined for purposes of the general business credit, but reduced by the amount of that credit.

An election to pay tax in installments must be made by the due date for the tax return for the taxable year in which the pre-effective-date undistributed CFC earnings are included in income. The Treasury Secretary has authority to prescribe the manner of making the election. The first installment must be paid on the due date (determined without regard to extensions) for the tax return for the taxable year of the income inclusion. Succeeding installments must be paid annually no later than the due dates (without extensions) for the income tax return of each succeeding year. If a deficiency is later determined with respect to the net tax liability, the additional tax due may be prorated among all installment payments in most circumstances. The portions of the deficiency prorated to an

[952] Other foreign tax credits used by a taxpayer against tax liability resulting from the deemed inclusion apply in full.

[953] 1ASec. 78.

installment that was due before the deficiency was assessed must be paid upon notice and demand. The portion prorated to any remaining installment is payable with the timely payment of that installment payment, unless the deficiency is attributable to negligence, intentional disregard of rules or regulations, or fraud with intent to evade tax, in which case the entire deficiency is payable upon notice and demand.

The timely payment of an installment does not incur interest. If a deficiency is determined that is attributable to an understatement of the net tax liability due under this provision, the deficiency is payable with underpayment interest for the period beginning on the date on which the net tax liability would have been due, without regard to an election to pay in installments, and ending with the payment of the deficiency. Furthermore, any amount of deficiency prorated to a remaining installment also bears interest on the deficiency, but not on the original installment amount.

The provision also includes an acceleration rule. If (1) there is a failure to pay timely any required installment, (2) there is a liquidation or sale of substantially all of the U.S. shareholder's assets (including in a bankruptcy case), (3) the U.S. shareholder ceases business, or (4) another similar circumstance arises, the unpaid portion of all remaining installments is due on the date of the event (or, in a title 11 or similar case, the day before the petition is filed).

Special rule for S corporations

A special rule permits deferral of the transition net tax liability for shareholders of a U.S. shareholder that is a flow-through entity known as an S corporation.[954] The S corporation is required to report on its income tax return the amount includible in gross income by reason of this provision, as well as the amount of deduction that would be allowable, and provide a copy of such information to its shareholders. Any shareholder of the S corporation may elect to defer his portion of the net tax liability at transition to the participation exemption system until the shareholder's taxable year in which a triggering event occurs. The election to defer the tax is due not later than the due date for the return of the S corporation for its last taxable year that begins before January 1, 2018.

Three types of events may trigger an end to deferral of the net tax liability. The first type of triggering event is a change in the status of the corporation as an S corporation. The second category includes liquidation, sale of substantially all corporate assets, termination of the company or end of business, or similar event, including reorganization in bankruptcy. The third type of triggering event is a transfer of shares of stock in the S corporation by the electing taxpayer, whether by sale, death or otherwise, unless the transferee of the stock agrees with the Secretary to be liable for net tax liability in the same manner as the transferor. Partial transfers trigger the end of deferral only with respect to the portion of tax properly allocable to the portion of stock sold.

[954] Section 1361 defines an S corporation as a domestic small business corporation that has an election in effect for status as an S corporation, with fewer than 100 shareholders, none of whom are nonresident aliens, and all of whom are individuals, estates, trusts or certain exempt organizations.

If a shareholder of an S corporation has elected deferral under the special rule for S corporation shareholders and a triggering event occurs, the S corporation and the electing shareholder are jointly and severally liable for any net tax liability and related interest or penalties. The period within which the IRS may collect such liability does not begin before the date of an event that triggers the end of the deferral. If an election to defer payment of the net tax liability is in effect for a shareholder, that shareholder must report the amount of the deferred net tax liability on each income tax return due during the period that the election is in effect. Failure to include that information with each income tax return will result in a penalty equal to five-percent of the amount that should have been reported.

After a triggering event occurs, a shareholder is the S corporation may elect to pay the net tax liability in eight equal installments, subject to rules similar to those generally applicable absent deferral. Whether a shareholder may elect to pay in installments depends upon the type of event that triggered the end of deferral. If the triggering event is a liquidation, sale of substantially all corporate assets, termination of the company or end of business, or similar event, the installment payment election is not available. Instead, the entire net tax liability is due upon notice and demand. The installment election is due with the timely return for the year in which the triggering event occurs. The first installment payment is required by the due date of the same return, determined without regard to extensions of time to file.

Future considerations

The Committee is aware that certain aspects of this section require additional attention. For example, the Committee recognizes that the definition of post-1986 earnings and profits could operate to count the same earnings twice where a specified foreign corporation makes a distribution to another specified foreign corporation on or after November 2, 2017, but prior to the end of the taxable year to which section 965 applies. The Committee intends to correct this inappropriate result. Additionally, the Committee is aware that the definition of post-1986 earnings and profits in this section includes a provision that increases post-1986 earnings and profits by the amount of any qualified deficit, within the meaning of section 952 of the Code. The Committee intends to revise this provision to allow qualified deficits to reduce post-1986 earnings and profits for purposes of section 965 and to ensure that qualified deficits taken into account under section 965 cannot be used to reduce future subpart F income. The Committee also understands that the existing net operating loss (NOL), overall domestic loss (ODL), and foreign tax credit carry-forward rules may interact with income inclusions arising from section 965 in ways that may not be appropriate and that require additional consideration.

EFFECTIVE DATE

The provision is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and with respect to U.S. shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end, and subsequent years.

B. Modifications Related to Foreign Tax Credit System

1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis (sec. 4101 of the bill and secs. 78, 902 and 960 of the Code)

REASONS FOR CHANGE

The Committee believes that a section 902 credit is not appropriate in a participation exemption system under which 100 percent of dividends received by certain domestic corporate shareholders of specified foreign corporations are exempt from U.S. taxation. To continue to offer section 902 credits for taxes deemed paid would result in a double benefit to the U.S. shareholder, by first allowing a dividend to be recognized in income with no U.S. tax liability associated therewith, and by further reducing existing U.S. tax liability with a credit for taxes paid on foreign source income. Rather, offering deemed paid foreign tax credits on a current year basis solely under section 960 reflects what the Committee believes to be a simpler and more appropriate application of the foreign tax credit regime in a 100 percent participation exemption system.

EXPLANATION OF PROVISION

The provision repeals the deemed-paid credit with respect to dividends received by a domestic corporation that owns 10 percent or more of the voting stock of a foreign corporation.

A deemed-paid credit is provided with respect to any income inclusion under subpart F. The deemed-paid credit is limited to the amount of foreign income taxes properly attributable to the subpart F inclusion. Foreign income taxes under the provision include income, war profits, or excess profits taxes paid or accrued by the CFC to any foreign country or possession of the United States. The provision eliminates the need for computing and tracking cumulative tax pools.

Additionally, the provision provides rules applicable to foreign taxes attributable to distributions from previously taxed earnings and profits, including distributions made through tiered-CFCs.

The Secretary is granted authority under the provision to provide regulations and other guidance as may be necessary and appropriate to carry out the purposes of this provision. It is anticipated that the Secretary would provide regulations with rules for allocating taxes similar to rules in place for purposes of determining the allocation of taxes to specific foreign tax credit baskets.[955] Under such rules, taxes are not attributable to an item of subpart F income if the base upon which the tax was imposed does not include the item of subpart F income. For example, if foreign law exempts a certain type of income from its tax base, no deemed-paid credit results from the inclusion of such income as subpart F. Tax imposed on income that is not included in subpart F income, is not considered attributable to subpart F income.

In addition to the rules described in this section, the provision makes several conforming amendments to various other sections of the Code reflecting the repeal of section 902 and the modification of section 960. These conforming amendments include amending

[955] See Treas. Reg. sec. 1.904–6(a).

the section 78 gross-up provision to apply solely to taxes deemed paid under the amended section 960.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

2. Source of income from sales of inventory determined solely on basis of production activities (sec. 4102 of the bill and sec. 863 of the Code)

REASONS FOR CHANGE

The Committee acknowledges that current administrative guidance, which sources sales income, in part, based on the place of destination rather than the place of production, may be appropriate in the context of our current tax system. However, the Committee believes this approach is not appropriate under a participation exemption system with lower tax rates. Rather than providing targeted relief to particular kinds of income, the Committee is instead reducing tax rates for all taxpayers, while also modernizing the U.S. system for taxing cross-border income. Therefore, the Committee believes changing present law in this area will more accurately measure foreign-source taxable income as part of providing a flatter, fairer, and simpler tax system.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

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

C. Modifications of Subpart F Provisions

1. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment (sec. 4201 of the bill and sec. 955 of the Code)

REASONS FOR CHANGE

In the transition to a participation exemption system, foreign earned income that is not subject to immediate inclusion in the U.S. shareholder's gross income under the subpart F regime will generally be exempt from U.S. taxation upon repatriation through a dividend paid from a specified foreign corporation to its U.S. shareholder. Foreign base company shipping income was repealed as a type of foreign base company income (and therefore, subpart F income) in 2004.[956] The Committee believes that since a CFC's foreign base shipping company income is no longer subject to immediate inclusion in its U.S. shareholder's gross income, a corresponding decrease in the CFC's investment in that otherwise exempt income should not trigger an immediate income inclusion to its U.S. shareholder.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders within which or with which such taxable years of foreign corporations end.

2. Repeal of treatment of foreign base company oil related income as subpart F income (sec. 4202 of the bill and sec. 954(a) of the Code)

REASONS FOR CHANGE

The move to a participation exemption system and the repeal of section 902 are expected to result in the loss of a significant amount of foreign tax credits that are attributable to foreign oil and gas operations and that are available to offset U.S. tax liability imposed on current inclusions of foreign base company oil related income. Consequently, the Committee is concerned that moving to a participation exemption system could undermine the intended application of those rules and put U.S. oil and gas companies at a competitive disadvantage relative to their foreign peers. Furthermore, the Committee believes the introduction of additional anti-base erosion rules under the bill obviates the need for separate anti-base erosion rules with respect to foreign oil and gas operations. Therefore, the Committee believes the foreign base company oil related income rules are not necessary in the context of the international tax reforms made in the bill.

EXPLANATION OF PROVISION

The provision eliminates foreign base company oil related income as a category of foreign base company income.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S.

[956] American Jobs Creation Act, Pub. L 108–357, 118 Stat. 1511 (Oct. 22, 2004).

shareholders in which or with which such taxable years of foreign corporations end.

3. Inflation adjustment of *de minimis* exception for foreign base company income (sec. 4203 of the bill and sec. 954(b)(3) of the Code)

REASON FOR CHANGE

The *de minimis* exception contained in current section 954(b)(3)(A) has not been adjusted for inflation since its enactment in 1986. The Committee believes that indexing the *de minimis* amount to inflation is warranted so that it serves as a more accurate reflection of the changing economic environment.

EXPLANATION OF PROVISION

The provision amends the *de minimis* exception of present law, which permits a CFC to exclude its foreign base company income if the sum of its total foreign base company income and gross insurance income is the lesser of 5 percent of its gross income or $1,000,000. In the case of any taxable year beginning after 2017, the provision indexes for inflation the $1,000,000 *de minimis* amount for foreign base company income, with all increases rounded to the nearest multiple of $50,000.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

4. Look-thru rule for related controlled foreign corporations made permanent (sec. 4204 of the bill and sec. 954(c)(6) of the Code)

REASONS FOR CHANGE

As was the case when section 954(c)(6) was originally enacted, today most countries allow their companies to redeploy active foreign earnings with no additional tax burden. The Committee believes that this provision will make U.S. companies and U.S. workers more competitive with respect to such countries. By allowing U.S. companies to reinvest their active foreign earnings where they are most needed without incurring additional tax that companies based in many other countries never incur, the Committee believes that the provision will continue to enable U.S. companies to make more sales overseas and thus produce more goods in the United States. These benefits should be enhanced by making this provision permanent, thereby eliminating uncertainty as to its future application.

EXPLANATION OF PROVISION

The provision makes the exclusion from foreign personal holding company income for certain dividends, interest (including factoring income that is treated as equivalent to interest under section 954(c)(1)(E)), rents, and royalties received or accrued by one CFC from a related CFC permanent.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2019, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

5. Modification of stock attribution rules for determining status as a controlled foreign corporation (sec. 4205 of the bill secs. 318, 958 and 6038 of the Code).

REASONS FOR CHANGE

The Committee is aware of certain transactions used to avoid subpart F provisions. One such transaction involves effectuating "de-control" of a foreign subsidiary, by taking advantage of the section 958(b)(4) rule that effectively turns off the constructive stock ownership rules of 318(a)(3) when to do otherwise would result in a U.S. person being treated as owning stock owned by a foreign person. Accordingly, such a transaction converts former CFCs to non-CFCs, despite continuous ownership by U.S. shareholders. The Committee believes this provision is necessary to render de-controlling transactions ineffective as a means of avoiding the subpart F provisions.

EXPLANATION OF PROVISION

The provision amends the ownership attribution rules of section 958(b) so that certain stock of a foreign corporation owned by a foreign person is attributed to a related U.S. person for purposes of determining whether the related U.S. person is a U.S. shareholder of the foreign corporation and, therefore, whether the foreign corporation is a CFC. In other words, the provision provides "downward attribution" from a foreign person to a related U.S. person in circumstances in which present law does not so provide. The pro rata share of a CFC's subpart F income that a U.S. shareholder is required to include in gross income, however, continues to be determined based on direct or indirect ownership of the CFC, without application of the new downward attribution rule. The Secretary is granted authority to alleviate any unnecessary reporting burdens that may be triggered by the provision.

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

6. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply (sec. 4206 of the bill and 951(a)(1) of the Code)

REASONS FOR CHANGE

The Committee believes the original purpose for the 30-day rule to facilitate tax administration—is no longer necessary in light of the availability of technology to track owner and corporate attributes on a daily basis. At the same time, the Committee believes the 30-day rule under present law provides inappropriate opportunities for taxpayers to structure transactions to avoid U.S. tax.

EXPLANATION OF PROVISION

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

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

D. Prevention of Base Erosion

1. Current year inclusion by United States shareholders with foreign high returns (sec. 4301 of the bill and secs. 78 and 960 and new sec. 951A of the Code)

REASONS FOR CHANGE

Under present law, multinational enterprises have flexibility to attribute profits to low-tax jurisdictions because each enterprise can structure transactions between affiliates in a manner that minimizes overall tax liability. The arm's length standard, which the Committee believes continues to be the best standard for determining the appropriate pricing of a transaction between affiliates, provides that profits are attributable based on the functions performed, the assets employed, and the risks assumed by the relevant parties.[957] To the extent that these functions, assets, and risks are mobile, taxpayers may seek to situate them in, or relocate them to, low-tax jurisdictions.

Changing the U.S. international tax system from a worldwide system of taxation to a participation exemption system of taxation exacerbates the incentive under present law to shift profits abroad. Specifically, under present law, most foreign profits earned through a subsidiary are not subject to current taxation but will eventually be subject to U.S. taxation upon repatriation. Under the participation exemption system provided for in the bill, however, foreign profits earned through a subsidiary generally will never be subject to U.S. taxation. Accordingly, new measures to protect against the erosion of the U.S. tax base are warranted.

One common form of erosion is the concentration of a multinational enterprise's high-value functions, assets, and risks abroad in low-tax jurisdictions in order to generate profits offshore. The internal supply chain giving rise to these profits may or may not involve U.S. activities, although the existence of a U.S. shareholder may indicate some U.S. connection (e.g., U.S. research and development, U.S.-sourced capital, etc.). The concentration of these functions, assets, and risks may occur through the relocation of employees, the acquisition or development of intellectual property offshore, or the contractual allocation of risk within the enterprise. Although present law addresses transfers of property from a U.S.

[957] See generally Treas. Reg. sec. 1.482–1 et seq.

shareholder to its foreign subsidiary[958] and subjects certain forms of passive or highly mobile income to current U.S. taxation,[959] present law does not adequately address the actions described in the preceding sentence.[960]

The Committee recognizes that multinational companies concentrate valuable functions, assets, and risks for reasons other than tax savings. For example, centralizing decision-making, quality control, and brand management into regional centers of excellence can provide significant value to an enterprise. This may result in the concentration of complex functions, valuable intellectual property, and entrepreneurial risk in a particular principal affiliate in a particular country, entirely independent of tax considerations. This also results, however, in significant profits being attributable to a single entity, which may result in significant tax savings if that entity is subject to a low effective tax rate. The Committee believes that the ability to obtain this result provides significant financial incentive for companies to structure in this manner in order to concentrate profits in low-tax jurisdictions, ultimately leading to the migration of valuable jobs and property from the United States.

Therefore, the Committee has studied various mechanisms for taxing high returns concentrated in U.S. shareholders' foreign subsidiaries. Other proposals, including those released by the Committee, have considered approaches based on specific transfers of intellectual property, foreign earnings attributable to all foreign activities, and foreign earnings attributable only to intellectual property.[961] These proposals have fallen short conceptually and administratively, leading the Committee to focus on foreign high returns.[962] Specifically, the Committee believes that foreign high returns attributable to mobile functions, assets, and risks are best measured as the excess of foreign earnings over a normal equity-holder's return on assets with limited mobility—*i.e.,* depreciable tangible property.[963] In making this measurement, the Committee recognizes the integrated nature of modern supply chains and believes it is more appropriate to look at a multinational enterprise's foreign operations on an aggregate basis, rather than by entity or by country.

Notwithstanding these considerations, certain kinds of income are not appropriately subject to scrutiny under additional anti-base

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[958] See, *e.g.,* secs. 367(d) and 482.

[959] See secs. 951–964; see also sec. 367(a)(3)(B).

[960] For example, the Tax Court has concluded a foreign subsidiary's use of its U.S. parent's business opportunities or employees does not necessarily constitute a compensable transfer of property. See *Hospital Corp. v. Commissioner,* 81 T.C. 520 (1983), nonacq. 1987–2 C.B. 1; *Veritas Software Corp. v. Commissioner,* 133 T.C. 297 (2009), nonacq. AOD–2010–05. Additionally, the Tax Court has concluded that a foreign subsidiary's use of its own resources, even if originating from or connected with its U.S. parent's resources, does not necessarily result in taxable income of the U.S. parent. See, *e.g., Amazon.com, Inc. v. Commissioner,* 148 T.C. No. 8 (2017); *Eaton Corp. v. Commissioner,* T.C. Memo. 2017–147; *Medtronic Inc. v. Commissioner,* T.C. Memo. 2016–112. The Committee does not believe the U.S. tax base would be adequately protected from erosion under a participation exemption system if these opportunities for concentrating high returns abroad remained available to taxpayers.

[961] See, *e.g.,* Ways and Means Discussion Draft, 112th Cong, 1st Sess. (October 26, 2011), available at *https://waysandmeans.house.gov/UploadedFiles/Discussion* Draft.pdf.

[962] See the Tax Reform Act of 2014, H.R. 1 (113th Cong., 2nd Sess., February 26, 2014). The Committee has also considered and continues to consider moving to a destination-based system of taxation, although the bill does not do so.

[963] The Committee also believes that looking to a normal equity-holder's return—*i.e.,* by excluding creditors' returns paid through interest—will prevent distortions that would otherwise arise if taxpayers could obtain a tax advantage by acquiring depreciable tangible property with debt that is not expected to produce a return in excess of the financing costs.

erosion rules. Subpart F income and ECI are already subject to full U.S. taxation and need not be subject to this provision's anti-base erosion rules. Income from the redeployment of active foreign earnings should not be subject to additional U.S. tax for the same reasons that section 954(c)(6) is made permanent under section 4204 of the bill—*i.e.,* to make U.S. companies and U.S. workers more competitive globally. Income subject to the active financing exception rules of sections 954(c)(2)(C), (h), and (i) have already passed scrutiny under existing anti-base erosion rules based on local presence and are unlikely to be the mobile income with which the Committee is concerned. And profits from the disposition of market-priced commodities generally do not relate to functions, assets, or risks easily relocated within a multinational group. Accordingly, these categories of income generally can be excluded in computing foreign high returns.

As previously mentioned, the Committee does not believe the concentration of high returns abroad by itself is a sufficient indicium of erosion of the U.S. tax base. Where those returns are subject to a low effective tax rate that achieves significant tax savings, however, the Committee believes base erosion may have been a consideration and that U.S. taxation is appropriate.

Conditioning the application of an anti-base erosion rule on low effective tax rates can be accomplished through a low-tax test or a reduced U.S. tax rate with a credit. Under the former approach, foreign earnings would be subject to U.S. tax only if the effective foreign tax rate is below a certain threshold, leading to a cliff effect and the potential for significant double taxation if credits are not allowed. Under the latter approach, U.S. tax is imposed at a reduced rate with a credit allowed for foreign taxes paid, which is more complex and encourages foreign jurisdictions to raise taxes to "soak up" the credit, but which also applies more smoothly to companies near the effective tax rate threshold. The Committee believes the latter approach is more favorable both to the competitiveness of U.S. workers and companies and the U.S. fisc. Furthermore, the Committee believes that relying on the framework of existing law can mitigate complexity and that partially disallowing foreign tax credits, combined with measuring foreign high return income and foreign taxes on such income on a global basis, will protect against foreign soak-up taxes. Determining the appropriate threshold for a low effective tax rate requires a balance between protecting the U.S. tax base and promoting the global competitiveness of U.S. workers and companies.

EXPLANATION OF PROVISION

In general

Under the provision, a U.S. shareholder of any CFC must include in gross income for a taxable year an amount equal to 50 percent of its foreign high return amount ("FHRA") in a manner generally similar to inclusions of subpart F income. FHRA means, with respect to any U.S. shareholder for the shareholder's taxable year, the shareholder's net CFC tested income less an amount equal to the excess (if any) of (1) the applicable percentage of the aggregate of the shareholder's pro rata share of the qualified business asset investment ("QBAI") of each CFC with respect to which it is a U.S.

shareholder over (2) the amount of interest expense taken into account in determining the shareholder's net CFC tested income. The applicable percentage is the Federal short-term rate (determined under section 1274(d) for the month in which such shareholder's taxable year ends) plus seven percentage points.

The formula for FHRA, which is calculated at the U.S. shareholder level, is generally:[964]

$$FHRA = Net\ CFC\ Tested\ Income - [(7\% + AFR) \times QBAI - Interest\ Expense]$$

where AFR is the short-term Federal rate.

Net CFC tested income

Net CFC tested income means, with respect to any U.S. shareholder, the excess of the aggregate of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder over the aggregate of its pro rata share of the tested loss of each CFC with respect to which it is a U.S. shareholder. Pro rata shares are determined under the rules of section 951(a)(2).

The formula for net CFC tested income, which is calculated at the U.S. shareholder level, is:

$$Net\ CFC\ Tested\ Income = Sum\ of\ CFC\ Tested\ Income - Sum\ of\ CFC\ Tested\ Loss$$

The tested income of a CFC means the excess (if any) of the gross income of the corporation determined without regard to amounts excluded from tested income, over deductions (including taxes) properly allocable to such gross income. The amounts excluded from test income are: (1) the corporation's ECI if the income is subject to tax;[965] (2) any gross income taken into account in determining the corporation's subpart F income; (3) any amount, except as otherwise provided by the Secretary, that qualifies for CFC look-through treatment, but only to the extent that any deduction allowable for the payment or accrual of such amount does not result in a reduction of the FHRA of any U.S. shareholder (determined without regard to such amount); (4) any gross income excluded as foreign personal holding company income by reason of the exceptions for active financing income and active insurance income, as well as the exception for dealers under section 954(c)(2)(C); (5) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (6) any dividend received from a related person (as defined in section 954(d)(3)); and (7) any commodities gross income.

Commodities gross income means (1) gross income of a corporation (or of a partnership in which the corporation is a partner) from the disposition of commodities that it has produced or extracted and that are commodities described in sections 475(e)(2)(A) and 475(e)(2)(D), and (2) the gross income of the corporation from the disposition of property that gives rise to income described in (1).

[964] If the amount of interest expense exceeds [(7% + AFR) x QBAI], then the quantity in brackets in the formula equals zero in the determination of FHRA.

[965] ECI includes income that is treated as ECI under a section 882(g) election. As a result, income that a CFC derives from certain sales to the U.S. market is excluded from the FHRA calculation and is subject to new section 4491, to the extent that the sales are made to a related party.

Commodities income is intended to include any foreign oil and gas extraction income[966] and any foreign oil related income.[967]

The tested loss of a CFC means the excess (if any) of the deductions (including taxes) properly allocable to the corporation's gross income determined without regard to the tested income exceptions over the amount of such gross income.

Qualified business asset investment

QBAI means, with respect to any CFC for a taxable year, the aggregate of its adjusted bases (determined as of the close of the taxable year and after any adjustments with respect to such taxable year) in specified tangible property used in its trade or business and with respect to which a deduction is allowable under section 168. Specified tangible property means any tangible property to the extent such property is used in the production of tested income or tested loss. The adjusted basis in any property is determined without regard to any provision of law that is enacted after the date of enactment of this provision, unless such law specifically and directly amends this provision's definition.

If a CFC holds an interest in a partnership as of the close of the corporation's taxable year, the corporation takes into account its distributive share of the aggregate of the partnership's adjusted bases (determined as of such date in the hands of the partnership) in tangible property held by the partnership to the extent that such property is used in the trade or business of the partnership, is of a type with respect to which a deduction is allowable under section 168, and is used in the production of tested income or tested loss (determined with respect to the corporation's distributive share of income or loss with respect to such property). The corporation's distributive share of the adjusted basis of any property is the corporation's distributive share of income and loss with respect to such property.

For purposes of determining QBAI, the Secretary is authorized to issue anti-avoidance regulations or other guidance as the Secretary determines appropriate, including regulations or other guidance that provide for the treatment of property if the property is transferred or held temporarily, or if avoidance was a factor in the transfer or holding of the property.

Foreign tax credits and coordination with subpart F

Deemed-paid credit for taxes properly attributable to tested income

For any FHRA included in the gross income of a domestic corporation, the corporation is deemed to have paid foreign income taxes equal to 80 percent of its foreign high return percentage multiplied by the aggregate tested foreign income taxes paid or accrued by each CFC with respect to which the corporation is a U.S. shareholder. The foreign high return percentage is the corporation's FHRA divided by the aggregate amount of its pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder. Tested foreign income taxes are the foreign income taxes paid or accrued by a CFC that are properly attributable to gross

[966] Sec. 907(c)(1).
[967] Sec. 907(c)(2).

income taken into account in determining tested income or tested loss.

The provision creates a separate foreign tax credit basket for the FHRA inclusion, with no carryforward or carryback available for excess credits. For purpose of determining the foreign tax credit limitation, any FHRA is not general category income, and income that can be classified as both a FHRA and passive category income is considered passive category income. The taxes deemed to have been paid are treated as an increase in the FHRA for purposes of section 78, determined by taking into account 100 percent of its foreign high return percentage multiplied by the the aggregate tested foreign income taxes.

Coordination with subpart F

Although FHRA inclusions do not constitute subpart F income, FHRA inclusions are generally treated similarly to subpart F inclusions. Thus, with respect to any CFC any pro rata amount from which is taken into account in determining the FHRA included in gross income of a U.S. shareholder, such amount, except as otherwise provided by the Secretary, is treated in the same manner as an amount included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 851(b), 904(h)(1), 959, 961, 962, 993(a)(1)(E), 996(f)(1), 1248(b)(1), 1248(d)(1), 6501(e)(1)(C), 6654(d)(2)(D), and 6655(e)(4).

The provision requires that the amount of FHRA included by a U.S. corporation be allocated across each CFC with respect to which it is a U.S. shareholder. The portion of the FHRA treated as being with respect to a CFC equals zero for a foreign corporation with tested loss and, for a foreign corporation with tested income, the portion of the FHRA which bears the same ratio to the total FHRA as the shareholder's pro rata amount of the tested income of the foreign corporation bears to the aggregate amount of the shareholder's pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder.

Tested losses taken into account in determining a U.S. shareholder's FHRA cannot also reduce the shareholder's inclusions in gross income under section 951(a)(1)(A) by reason of the earnings and profits limitation in section 952(c). Accordingly, a U.S. shareholder's amount included in gross income under section 951(a)(1)(A) with respect to a CFC is determined by increasing the earnings and profits of such corporation (solely for purposes of determining such amount) by an amount that bears the same ratio (not greater than 1) to the shareholder's pro rata share of the tested loss of such CFC as (1) the aggregate amount of the shareholder's pro rata share of the tested income of each CFC with respect to which it is a U.S. shareholder bears to (2) the aggregate amount of the shareholder's tested loss of each CFC with respect to which it is a U.S. shareholder. If this increase in earnings and profits results in an incremental inclusion under section 951(a)(1)(A), the CFC will increases its earnings and profits described in section 959(c)(2) by that amount and decrease its earnings and profits in section 959(c)(3) by that amount (even if that results in, or increases, a deficit).

Taxable years for which persons are treated as U.S. shareholders of a CFC

For purposes of the FHRA inclusion, a U.S. shareholder of a CFC is treated as a U.S. shareholder of the corporation for any taxable year of the shareholder if a taxable year of the corporation ends in or with the taxable year of such person and the person owns (within the meaning of section 958(a)) stock in the corporation on the last day in the taxable year of the corporation on which the corporation is a CFC. A corporation is generally treated as a CFC for any taxable year if the corporation is a CFC at any time during the taxable year.

Examples

The following examples illustrate how FHRA is calculated. The examples are highly stylized and are not meant to represent actual taxpayer scenarios.

Example 1: Two Wholly Owned CFCs, Each with Tested Income

Assume a domestic corporation, US1, wholly owns two CFCs, CFC1 and CFC2. These are the only CFCs with respect to which US1 is a U.S. shareholder. Assume that the applicable percentage to be applied to QBAI is 10 percent. The following table includes more information about CFC1 and CFC2. Assume that their foreign sales income are items of gross income included in the computation of tested income, and that all expenses are allocable to their foreign sales income. Also assume a U.S. corporate tax rate of 20 percent, and that the foreign tax rates faced by CFC1 and CFC2 are applied evenly across each of its sources of income.

FACTS FOR EXAMPLE 1

	CFC1	CFC2
GROSS INCOME		
Foreign Sales Income	$300	$2,000
Subpart F Income	$100	$0
Commodities Income	$600	$0
EXPENSES		
Operating Expenses	$200	$300
NET INCOME	$800	$1,700
Foreign Tax Rate	20 percent	5 percent
QBAI	$500	$0

CFC-level calculations of tested income and QBAI

CFC1 has foreign sales income of $300 (assumed to be included in the tested income calculation) and expenses of $220 (including $20 of taxes, computed below) allocable to its foreign sales income. Therefore, it has tested income of $80 (= $300 − $220) and tested foreign income tax of $20 (= 20% × $100). CFC1 has QBAI of $500.

CFC2 has foreign sales income of $2,000 (assumed to be included in the tested income calculation) and expenses of $385 (including $85 of taxes, computed below) allocable to its foreign sales income. Therefore, it has tested income of $1,615 (= $2,000 − $385) and tested foreign income tax of $85 (= 5% × $1,700). CFC2 has QBAI of $0.

U.S.-shareholder-level calculation of FHRA and tax liability US1 has net CFC tested income of $1,695, which is the sum of CFC1's tested income of $80 and CFC2's tested income of $1,615. Its pro rata share of QBAI is $500 (= [100% × $500] + [100% × $0]). No interest expense is taken into account in determining US1's net CFC tested income. Therefore, US1's FHRA = $1,695 − ([10% × $500] − $0) = $1,645.

US1 receives a deemed-paid credit equal to 80 percent of its foreign high return percentage multiplied by the aggregate tested foreign income taxes paid or accrued by CFC1 and CFC2. Its foreign high return percentage is 97.1 percent (= FHRA/Aggregate Tested Income = $1,645/$1,695). The aggregate tested foreign income taxes paid or accrued by CFC1 and CFC2 is $105 (= $20 + $85). Therefore, US1's deemed-paid credit is 80 percent × 97.1 percent × $105 = $81.52.

US1 includes 50 percent of its FHRA and 50 percent of its section 78 gross-up in gross income, or $873.45 (= 50% × [$1,645 × $101.90]).[968] The tentative U.S. tax owed on this income is the U.S. corporate tax rate of 20 percent applied to the total inclusion of $873.45, or $174.69.

The residual U.S. tax paid by US1 on its FHRA is its tentative U.S. tax of $174.69 less its deemed-paid credit of $81.52, or $93.17, for an effective U.S. tax rate (after foreign tax credits) of 5.7 percent on its FHRA of $1,645.

Example 2: Variant of Example 1, With Tested Loss

Example 2 generally has the same facts as example 1, except that CFC2 has foreign sales of $360. This means that CFC2 has tested income (before taking into account taxes) of $60. Assume, for simplicity, that it still pays foreign taxes of $85 with respect to the $360 of foreign sales, so that its tested loss is $25 (= $60 − $85) and its tested foreign income tax is $85.

Like in Example 1, CFC1 has tested income of $80 and tested foreign income tax of $20.

U.S.-shareholder-level calculation of FHRA and tax liability

US1 has net CFC tested income of $55, which is CFC1's tested income of $80 less CFC2's tested loss of $25. Its pro rata share of QBAI is $500 (= [100% × $500] + [100% × $0]). No interest expense is taken into account in determining US1's net CFC tested income. Therefore, US1's FHRA = $55 − (10% × $500) − $0 = $5.

US1 receives a deemed-paid credit equal to 80 percent of its foreign high return percentage multiplied by the aggregate tested foreign income taxes paid or accrued by CFC1 and CFC2. Its foreign high return percentage is 5 percent (= FHRA/Aggregate Tested Income = $5/$100). The aggregate tested foreign income taxes paid or accrued by CFC1 and CFC2 is $105 (= $20 + $85). Therefore, US1's deemed-paid credit is 80 percent × 5 percent × $105 = $4.20.

US1 includes 50 percent of its FHRA in gross income and 50 percent of its section 78 gross-up in gross income, or $5.13 (= 50% × [$5 + $5.25]).[969] The tentative U.S. tax owed on this income is the

[968] The section 78 gross-up amount = 100 percent × 97.1 percent × $105 = 101.90

[969] The section 78 gross-up amount = 100 percent × 5 percent × $105 = $5.25

U.S. corporate tax rate of 20 percent applied to the total inclusion of $5.13, or $1.03.

The residual U.S. tax paid by US1 on its FHRA is its tentative U.S. tax of $1.03 less its deemed-paid credit of $5.25, or $0, for an effective U.S. tax rate of 0% on its FHRA of $5. The amount of US1's deemed-paid credit that is unused, $4.22, may not be carried back or carried forward.

Example 3: CFC Look-Through Payment

Example 3 illustrates how the FHRA calculation is applied when there are payments that qualify for CFC look-through treatment. Example 3 is limited to the calculation of the FHRA and does not provide calculations of the amount of U.S. or foreign income tax related to the FHRA.

USCo, a domestic corporation, wholly owns US1 and US2, each a domestic corporation. US1 wholly owns CFC1, and US2 wholly owns CFC2. These are the only CFCs with respect to which either US1 or US2 is a U.S. shareholder. Assume the applicable percentage for QBAI is 10 percent.

CFC1 has total gross income of $100, none of which qualifies for a tested income exception, and has interest expense of $30, which it pays to CFC2. CFC1 has no other deductions and has QBAI of $200. As a result, CFC1 has tested income of $70 (= $100 of gross income less $30 of interest expense). US1's net CFC tested income is $70 and the applicable percentage of its pro rata share of QBAI is $20 (= 10% × $200). As CFC1's interest expense of $30 was taken into account in determining its tested income of $70, the excess of US1's applicable percentage of QBAI over this amount of interest expense is $0. As a result, US1's FHRA is $70 (= $70 − $0).

CFC2 has $30 of interest income, all of which qualifies for CFC look-through treatment because CFC1 has no subpart F income. Assume CFC2 has no other gross income, no deductions, and no QBAI. CFC2's interest income is not includible in its tested income, but only to the extent a deduction for its payment or accrual does not reduce the FHRA of any U.S. shareholder. Absent the $30 interest expense deduction used in determining its net CFC tested income, US1's net CFC tested income would have been $100, and US1's FHRA would have been $80 (= $100 − $20). With the $30 deduction, US1's net CFC's tested income is $70. Therefore, the deduction allowable for the payment or accrual of the interest reduced the FHRA of US1 by $10, so only $20 of CFC2's interest income is excluded from tested income. As a result, CFC2 has tested income of $10 (= $30 − $20), and US2 has net CFC tested income of $10 (= $10 − $0).

EFFECTIVE DATE

The provision is effective for taxable years of foreign corporations beginning after December 31, 2017, and for taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

2. Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group (sec. 4302 of the bill and sec. 163 of the Code)

REASONS FOR CHANGE

The Committee believes that it is important to provide measures to discourage excessive leverage directly in conjunction with the adoption of a participation exemption system. The Committee further believes that 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 in a manner that applies equally to foreign and U.S. companies in order to provide a level playing field while recognizing standard non-tax business practices that involve parent corporations incurring debt to finance the acquisition or establishment of subsidiaries. The fungibility of money and the ease with which multinational enterprises may generally redeploy capital among affiliates within the group provides multinational enterprises with significant flexibility in locating interest expense within the group. Under present law, this enables multinational enterprises to locate significant interest expense in high-tax jurisdictions such as the United States in order to maximize the tax benefits of interest deductions, irrespective of the location of the operations funded by the debt proceeds. Furthermore, U.S. subsidiaries of foreign-parented multinationals have an incentive to issue related-party debt to increase the interest deductions allowed against U.S. taxable income. Present law provides a limited set of rules to combat these concerns.[970]

Therefore, the Committee believes it is necessary to restrict the deductibility of interest by a U.S. taxpayer to the extent to which the interest expense gives rise to U.S. taxable income. Similarly, the Committee does not believe interest expense should be deductible to the extent it gives rise to foreign earnings, whether of a foreign subsidiary or of a non-subsidiary foreign affiliate, that will never be subject to U.S. tax.

In applying such a limitation, the Committee is cognizant of the imperative to provide U.S. and foreign companies with a level playing field. Accordingly, the Committee's approach applies equally to U.S.- and foreign-parented multinationals. In order for such an approach to be administrable, it is appropriate to look at information readily available to U.S. and foreign companies alike, as well as the IRS, such as financial accounting information, so as to minimize the need for burdensome calculations and record-keeping specific to U.S. tax considerations.

[970] With respect to the former concern, interest expense allocation rules generally limit the availability of foreign tax credits to the extent a U.S. shareholder deducts interest to fund the operations of its foreign subsidiaries. See Treas. Reg. secs. 1.861–8 through –13T. With respect to the latter concern, sections 163(j), 267(a)(3), and 482 limit the deductibility of related-party interest payments in certain circumstances, and the subpart F rules limit the U.S. tax benefits of issuing debt to a foreign subsidiary. Additionally, recent regulations issued under section 385 limit the deductibility of related-party interest payments in certain cases by recharacterizing intercompany debt instruments as equity.

EXPLANATION OF PROVISION

The provision limits the amount of U.S. interest expense that a domestic corporation which is a member of an international financial reporting group can deduct to the sum of the member's interest income plus the allowable percentage of 110 percent of net interest expense. An international financial reporting group is a group that: (1) includes at least one foreign corporation engaged in a U.S. trade or business or at least one domestic corporation and one foreign corporation at any time during the group's reporting year, (2) prepares consolidated financial statements in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), International Financial Reporting Standards ("IFRS"), or any other comparable method identified by the Secretary,[971] and (3) reports in such statements average annual gross receipts in excess of $100,000,000 (determined in the aggregate with respect to all entities which are part of such group) for the three-reporting-year period ending with such reporting year.

The allowable percentage is the ratio of a corporation's allocable share of the international financial reporting group's net interest expense over such corporation's reported net interest expense. A corporation's allocable share of an international financial reporting group's net interest expense is determined based on the corporation's share of the group's earnings (computed by adding back net interest expense, taxes, depreciation, and amortization) as reflected in the group's consolidated financial statements. A corporation's reported net interest expense is its net interest expense reported in the books and records used to prepare the group's consolidated financial statements. For international financial reporting groups that do not prepare consolidated financial statements under U.S. GAAP, IFRS, or any other comparable method identified by the Secretary and which are filed with the United States Securities and Exchange Commission, the provision provides a hierarchy of other audited consolidated financial statements that may be relied upon by such group.

The provision applies to partnerships at the partnership level under rules similar to the rules of section 3301 of the bill. The provision also applies to foreign corporations engaged in a U.S. trade or business. A U.S. consolidated group is considered a single corporation under this provision.

The amount of any interest not allowed as a deduction for any taxable year by reason of this provision or section 3301 of the bill (depending on whichever imposes the lower limitation for the amount allowed as an interest deduction with respect to such taxable year) can be carried forward as interest (and as business interest for purposes of section 3301 of the bill) for up to five years.

The following example illustrates the coordination of this provision with section 3301 of the bill in a context involving a partnership.

[971] The International Financial Reporting Standards are a set of accounting standards commonly used for the preparation of financial statements of public companies listed in countries outside the United States.

Example

FP, a foreign corporation, wholly owns USS, a domestic corporation. FP and USS each own 50 percent of PS, a partnership. FP, USS, and PS prepare audited consolidated financial statements in accordance with U.S. GAAP that are used for internal management purposes and under which average annual gross receipts for the 3-reporting-year period ending with the current reporting year in excess of $100 million are reported. During the current reporting year, the FP–USS–PS group has consolidated EBITDA of 300 and consolidated interest expense of 50. During that period, USS has EBITDA of 50 (determined without regard to distributions from PS), reported interest expense of 25, business interest of 30, and adjusted taxable income (determined without regard to USS's distributive share of PS's non-separately stated taxable income or loss) of 40. Also during that period, PS has EBITDA of 150, reported interest expense of 15, business interest of 20, and adjusted taxable income of 120.

PS's business interest is deductible only to the extent it does not exceed the limitations in each of section 163(j) (as provided in section 3301 of the bill) and section 163(n) (as provided in section 4302 of the bill). PS's limitation under section 163(j) is 36, which equals 30 percent of its adjusted taxable income of 120 (*i.e.*, 30% × 120 = 36). PS's limitation under section 163(n) is 22, which equals the allowable percentage (*i.e.*, 160% = 50 × 150/300/15, not greater than 100%) of 110 percent of PS's business interest (*i.e.*, 22 = 110% × 20). Therefore, all 20 of PS's business interest is deductible. PS's excess amount under section 163(j) (*i.e.*, 36 − 20 = 16) and excess EBITDA under section 163(n) (*i.e.*, 150 − 300 × 15/50 = 60) flow through to its partners.

Similarly, USS's business interest is deductible only to the extent it does not exceed the limitations in each of section 163(j) and section 163(n). USS's limitation under section 163(j) is 20, which equals 30 percent of the sum of its adjustable taxable income of 40 (determined without regard to USS's distributive share of PS's non-separately stated taxable income or loss) or 12 (*i.e.*, 30% × 40 = 12) plus USS's distributive share of PS's excess amount under section 163(j)(3)(B) (*i.e.*, 50% × 16 = 8). USS's limitation under section 163(n) is 17.60, which equals the allowable percentage (*i.e.*, 53% = 50 × (50 + 30)/300/25) of 110 percent of USS's business interest (*i.e.*, 33 = 110% × 30) after taking into account USS's distributive share of PS's excess EBITDA under section 163(n) (*i.e.*, 50% × 60 = 30). Therefore, USS may deduct 17.60 of its 30 of business interest in the current year.

EFFECTIVE DATE

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

3. Excise tax on certain payments from domestic corporations to related foreign corporations; election to treat such payments as effectively connected income (sec. 4303 of the bill and secs. 882, 4491, 6038C, and 6038E of the Code)

REASONS FOR CHANGE

The Committee recognizes that, under the current system, companies have been able to base erode by making outbound, related-party deductible payments. This is true for both foreign-and U.S.-parented multinationals, the former of which often make outbound royalty or interest payments, and the latter of which make outbound payments to remunerate foreign affiliates for tangible goods or intercompany services. There is no reason to believe such behavior would not continue in the future. The Committee is not persuaded by arguments that once the United States has a competitive corporate tax rate, multinationals will have no incentive to base erode. Indeed, in a participation exemption system, the need for anti-base erosion measures remains critical as long as there are foreign jurisdictions in which corporations can achieve effective tax rates lower than that which they can achieve in the United States. That is to say, until the United States has a corporate tax rate of zero, there will be a need for anti-base erosion measures. The Committee believes it is of paramount importance that anti-base erosion measures designed to address this problem apply equally to U.S. and foreign multinationals.

In the context of this provision, it is critical to note that the Committee views base erosion in the truest, most fundamental sense of the term—U.S. taxpayers reducing their base of U.S. taxable income by making certain payments to foreign affiliates. The Committee recognizes the importance and vitality of transfer pricing generally, and of section 482, its regulations, and the vast body of case law and administrative guidance issued to date specifically. The Committee affirms its belief that the arm's length standard continues to be the foundational principle underpinning the pricing of intercompany transactions. However, the role transfer pricing plays in the larger base erosion problem cannot be ignored.

The basic tenets of transfer pricing rules—in the United States and worldwide—operate on the premise that related entities are to be remunerated for their activities on the basis of the functions performed, assets owned, and risks undertaken. Within these parameters, multinationals have the unique ability to determine which entities will be endowed with the high value assets, complex functions and risk-bearing activities within the supply chain, and thereby justify the higher profits these entities are rightfully deemed to earn under even the most accurate application of section 482 principles. The Committee is concerned that these entities are often, and increasingly, overseas. Thus, the base erosion problem remains and is exacerbated; whether the price is arm's length or not, multinationals are permitted to send payments to foreign affiliates to compensate them for their activities. In the course of so doing, the U.S. affiliate enjoys a deduction (or another tax benefit to reduce its U.S. taxable income), while the foreign affiliate generates foreign source income that will never be subject to U.S. tax. Accordingly, rather than implementing a provision to combat perceived transfer pricing abuses, the Committee instead seeks to address the mismatch created by the reduction to U.S. taxable income via outbound, related-party payments and the recognition of foreign income that is attributable to those payments and never subject to U.S. tax.

The Committee recognizes that instances of double taxation are possible when the corresponding foreign jurisdiction also taxes the foreign-earned income. Relief is provided through the allowance of a partial foreign tax credit.

EXPLANATION OF PROVISION

In general

This provision imposes an excise tax on certain amounts paid by U.S. payors to certain related foreign recipients to the extent the amounts are deductible by the U.S. payor. However, the excise tax does not apply if the foreign recipient elects to be subject to U.S. income tax on the amounts received. In calculating the U.S. income tax liability imposed under such an election, deemed expenses are allowed as a deduction. A foreign tax credit of 80% of applicable foreign credits are allowed against the U.S. tax liability imposed by this provision if an election is made.

Excise tax

The provision provides for an excise tax on specified amounts paid or incurred by a domestic corporation to a foreign corporation if both the foreign and domestic corporations are members of the same international financial reporting group. The amount of the tax is equal to 20 percent of the specified amounts paid or incurred. The excise tax is not imposed with respect to amounts that are or are deemed to be effectively connected with a U.S. trade or business of the foreign corporation. The excise tax imposed is neither deductible nor creditable.

A specified amount is any amount which is allowable by the payor as a deduction or includible in costs of goods sold, or inventory, or in the basis of an amortizable or depreciable asset. A specified amount does not include: (i) interest, (ii) an amount paid or incurred for the acquisition of a security defined in section 475(c)(2) (without regard to the last sentence thereof) or a commodity defined in sections 475(e)(2), that is, a commodity actively traded within the meaning of section 1092(d)(1) or an identified hedge of such commodity, or, (iii) for a payor which has elected to use a services cost method under section 482, an amount paid or incurred for services if such amount is the total services cost with no markup.

An international financial reporting group is any group of entities that prepares consolidated financial statements [972] if the aver-

[972] This term is defined in new section 163(n)(4) as a financial statement certified as being prepared in accordance with generally accepted accounting principles, international financial reporting standards, or any other comparable method of accounting identified by the Secretary of the Treasury and which is: (i) a 10–K (or successor form), or annual statement to shareholders required to be filed with the United States Securities and Exchange Commission, or, if this is not available, (ii) an audited financial statement used for (1) credit purposes, (2) reporting to shareholders, partners or other proprietors, or to beneficiaries, or (3) any other substantial nontax purpose, or, if (i) and (ii) are not available, (iii) filed with any other Federal or State agency for nontax purposes, or, if (i), (ii), or (iii) are not available, a financial statement used for a purpose described in (ii)(1), (2) and (3), or filed with any regulatory or governmental body, within or outside the United States, specified by the Secretary of the Treasury.

age annual aggregate payment amount for the group for the three-year period ending in the reporting year exceeds $100,000,000. The annual aggregate payment amount means the aggregate of the specified amounts made by U.S. members of the group to foreign members of the group during the reporting year.

Partnerships and branches

For purposes of this provision, a partnership is treated as an aggregate of its partners. Accordingly, a payment made to a partnership is treated as a payment to the partners, and a payment from a partnership is treated as a payment from the partners, in an amount equal to the partner's distributive share of the relevant item of income, gain, deduction, or loss.

For purposes of this provision, U.S. branches are treated as separate entities for purposes of determining the treatment of payments between a branch and entities other than its owner and for purposes of deemed payments between a branch and its owner.

Election to treat payments as effectively connected income

If a specified amount is paid or incurred by a domestic corporation with respect to a foreign corporation and both the foreign and domestic corporations are members of the same international financial reporting group, the foreign corporation may elect to take into account all such specified amounts as if the foreign corporation were engaged in a U.S. trade or business and had a permanent establishment and as if the payment were effectively connected with that U.S. trade or business and were attributable to the permanent establishment, irrespective of any otherwise applicable treaty. If the foreign corporation makes such election, the excise tax is not imposed and tax is imposed on a net basis on such specified amounts less deemed expenses. The election applies for the taxable year for which the election is made and all subsequent taxable years unless revoked with consent of the Secretary of the Treasury.

In general, the amount treated as effectively connected income under this provision is treated as such for all purposes of the Code. For example, it is subject to the branch profit tax (unless otherwise reduced, such as by an applicable treaty) and is not subject to the excise tax under section 4371. However, for purposes of section 245 and new section 245A, these amounts are not treated as effectively connected income. Therefore, a distribution of earnings attributable to the amounts described in this provision is eligible for the participation DRD under new section 245A.

The deemed expenses with respect to any specified amount received by a foreign corporation during any reporting year is the amount of expenses such that the net income ratio of the foreign corporation with respect to the specified amount (taking into account only such specified amounts and such deemed expenses) is equal to the net income ratio of the international financial reporting group determined for the reporting year with respect to the product line to which the specified amount relates. The net income ratio is the ratio of net income determined without regard to income taxes, interest income, and interest expense, divided by revenue. The net income ratio is calculated in accordance with the books and records used in preparing the group's consolidated financial statements. The net income ratio is determined by taking into account only revenues and expenses of the foreign members of the international financial reporting group (other than the members of the group that are or are treated as domestic corporations for purposes of the provision) derived from, or incurred with respect to, persons that are not members of the group or members of the group that are or are treated as domestic corporations for purposes of the provision.

The following example illustrates the determination of a foreign affiliate's deemed expenses under the provision:

According to the books and records (after taking into account intercompany transactions otherwise eliminated in consolidation) of an international financial reporting group consisting of US, FS1, and FS2, a domestic corporation, US has third-party revenues of $1000, incurs third-party expenses of $500, and makes a $300 payment for intercompany services to its foreign affiliate, FS1. FS1 has revenues of $500 ($200 of which are third-party) and incurs third-party expenses of $250. US's other foreign affiliate, FS2, has $300 of revenues, incurs $150 of third-party expenses, and makes a $100 intercompany payment to US. US's entire payment to FS1 is deductible for Federal income tax purposes, and FS1 elects to treat the $300 amount as subject to section 882(g)(1). On a consolidated basis, the US–FS1–FS2 group has revenues of $1500 and incurs third-party expenses of $900.

To determine the foreign affiliate's deemed expenses, its foreign profit margin will be determined by reference to ratio of the foreign earnings before interest and taxes ("EBIT") against the foreign revenues, with adjustments for related party inbound and outbound payments. In other words, the foreign affiliate's profit margin can be determined as follows:

$$(GEBIT - USEBIT + RPOP - RPIP) \div (GREV - USREV - USREV + RPOP)$$

GEBIT is global EBIT (determined on a consolidated basis), USEBIT is the domestic corporation's EBIT (without regard to related party transactions), RPOP is the group's related party outbound payments made from domestic corporations to foreign affiliates, and RPIP is the group's related party inbound payments made from foreign affiliates to domestic corporations.

In the denominator, GREV is global revenues (determined on a consolidated basis) and USREV is the domestic corporation's revenues (without regard to related party transactions).

Under the aforementioned facts, the foreign affiliate's profit margin would be 37.5%, or

$$(600 - 500 + 300 - 100) \div (1500 - 1000 + 300)$$

Accordingly, of the $300 payment from U.S. to FS1, $112.50 would be deemed to be income effectively connected to a U.S. trade or business, and subject to corporate tax. The remaining $187.50 of the payment would be deemed expenses for which FSI would be allowed a deduction.

Coordination with FDAP

Amounts treated as effectively connected income under this provision are not excluded from the definition of fixed or determinable annual or periodical ("FDAP") income. Payments subject to tax under section 881 do not constitute specified payments under this provision except to the extent that the rate of tax imposed under section 881 is reduced by a bilateral income tax treaty.

Joint and several liability

If there is an underpayment with respect to any taxable year of an electing foreign corporation which is a member of an international financial accounting group, each domestic corporation in the group is jointly and severally liable for as much of the underpayment as does not exceed the excess of such underpayment over the amount of such underpayment determined without regard to this rule and any penalty, addition to tax, or additional amount attributable to the above amount.

Foreign tax credit

The foreign tax credit allowed under section 906(a) with respect to amounts taken into account as effectively connected income is limited to 80 percent of the amount of taxes paid or accrued (and determined without regard to section 906(b)(1)). These foreign tax credits are effectively separately basketed and may not be carried backwards or forwards.

Reporting

An electing foreign corporation that receives a specified amount is required to report, with respect to each member of the international financial reporting group from which any such amount is received: (i) the name and taxpayer identification number of each member, (ii) the aggregate amounts received from each member, (iii) the product lines to which such amounts relate, the aggregate amounts relating to each product line, and the net income ratio for each product line, and (iv) a summary of changes in financial accounting methods that affect the computation of any net income ratio described above.

A domestic corporation that pays or accrues a specified amount with respect to which a foreign corporation has made the election is required to make a return according to the forms and regulations prescribed by the Secretary of the Treasury containing certain information and to maintain sufficient records to determine the tax liability imposed by this provision. The information required to be provided is as follows: (1) the name and taxpayer identification number of the common parent of the international financial reporting group of which the domestic corporation is a member, and (2) with respect to a specified amount: (A) the name and taxpayer identification number of the recipient of the amount, (B) the aggregate amounts received by the recipient, (C) the product lines to which the amounts relate and the aggregate amounts for each product line, and the net income ratio for each product line, and (D) a summary of any changes in financial accounting methods that affect the computation of any net income ratio described in (C).

Treasury may prescribe regulations or other guidance that address reporting requirements of foreign affiliates under this provision, such as allowing reporting or elections on a group basis.

EFFECTIVE DATE

The provisions of this section apply to amounts paid or incurred after December 31, 2018.

E. Provisions Related to Possessions of the United States

1. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sec. 4401 of the bill and sec. 199 of the Code)

PRESENT LAW

In general

Present law generally provides a deduction from taxable income (or, in the case of an individual, adjusted gross income) that is equal to nine percent of the lesser of the taxpayer's qualified production activities income or taxable income for the taxable year. For taxpayers subject to the 35-percent corporate income tax rate, the nine-percent deduction effectively reduces the corporate income tax rate to slightly less than 32 percent on qualified production activities income.

In general, qualified production activities income is equal to domestic production gross receipts reduced by the sum of: (1) the costs of goods sold that are allocable to those receipts; and (2) other expenses, losses, or deductions which are properly allocable to those receipts.

Domestic production gross receipts generally are gross receipts of a taxpayer that are derived from: (1) any sale, exchange, or other disposition, or any lease, rental, or license, of qualifying production property[973] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States; (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[974] produced by the taxpayer; (3) any lease, rental, license, sale, exchange, or other disposition of electricity, natural gas, or potable water produced by the taxpayer in the United States; (4) construction of real property performed in the United States by a taxpayer in the ordinary course of a construction trade or business; or (5) engineering or architectural services performed in the United States for the construction of real property located in the United States.

The amount of the deduction for a taxable year is limited to 50 percent of the wages paid by the taxpayer, and properly allocable to domestic production gross receipts, during the calendar year that ends in such taxable year.[975] Wages paid to bona fide residents of

[973] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[974] Qualified film includes any motion picture film or videotape (including live or delayed television programming, but not including certain sexually explicit productions) if 50 percent or more of the total compensation relating to the production of the film (including compensation in the form of residuals and participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

[975] For purposes of the provision, "wages" include the sum of the amounts of wages as defined in section 3401(a) and elective deferrals that the taxpayer properly reports to the Social Security Administration with respect to the employment of employees of the taxpayer during the calendar year ending during the taxpayer's taxable year.

Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.[976]

Rules for Puerto Rico

When used in the Code in a geographical sense, the term "United States" generally includes only the States and the District of Columbia.[977] A special rule for determining domestic production gross receipts, however, provides that in the case of any taxpayer with gross receipts from sources within the Commonwealth of Puerto Rico, the term "United States" includes the Commonwealth of Puerto Rico, but only if all of the taxpayer's Puerto Rico-sourced gross receipts are taxable under the Federal income tax for individuals or corporations.[978] In computing the 50-percent wage limitation, the taxpayer is permitted to take into account wages paid to bona fide residents of Puerto Rico for services performed in Puerto Rico.[979]

The special rules for Puerto Rico apply only with respect to the first 11 taxable years of a taxpayer beginning after December 31, 2005, and before January 1, 2017.

REASONS FOR CHANGE

The Committee recognizes the importance of supporting manufacturing activities in Puerto Rico, as such activities promote employment and investment.

EXPLANATION OF PROVISION

The provision extends the special domestic production activities rules for Puerto Rico to apply for the first 12 taxable years of a taxpayer beginning after December 31, 2005 and before January 1, 2018.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2016.

2. Extension of temporary increase in limit on cover over of rum excise taxes to Puerto Rico and the Virgin Islands (sec. 4402 of the bill and sec. 119(d) of the Code)

PRESENT LAW

A $13.50 per proof gallon[980] excise tax is imposed on distilled spirits produced in or imported into the United States.[981] The excise tax does not apply to distilled spirits that are exported from the United States, including exports to U.S. possessions (e.g., Puerto Rico and the Virgin Islands).[982]

The Code provides for cover over (payment) to Puerto Rico and the Virgin Islands of the excise tax imposed on rum imported (or

[976] Section 3401(a)(8)(C) excludes wages paid to United States citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.
[977] Sec. 7701(a)(9).
[978] Sec. 199(d)(8)(A).
[979] Sec. 199(d)(8)(B).
[980] A proof gallon is a liquid gallon consisting of 50 percent alcohol. See secs. 5002(a)(10) and (11).
[981] Sec. 5001(a)(1).
[982] Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).

brought) into the United States, without regard to the country of origin.[983] The amount of the cover over is limited under Code section 7652(f) to $10.50 per proof gallon ($13.25 per proof gallon before January 1, 2017).

Tax amounts attributable to shipments to the United States of rum produced in Puerto Rico are covered over to Puerto Rico. Tax amounts attributable to shipments to the United States of rum produced in the Virgin Islands are covered over to the Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the Virgin Islands are divided and covered over to the two possessions under a formula.[984] Amounts covered over to Puerto Rico and the Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[985] All of the amounts covered over are subject to the limitation.

REASONS FOR CHANGE

The Committee recognizes the importance of providing dedicated revenue sources to Puerto Rico and the Virgin Islands in order to fund their economic development and infrastructure.

EXPLANATION OF PROVISION

The provision suspends for six years the $10.50 per proof gallon limitation on the amount of excise taxes on rum covered over to Puerto Rico and the Virgin Islands. Under the provision, the cover-over limitation of $13.25 per proof gallon is extended for rum brought into the United States after December 31, 2016, and before January 1, 2023. After December 31, 2022, the cover over amount reverts to $10.50 per proof gallon.

EFFECTIVE DATE

The provision applies to distilled spirits brought into the United States after December 31, 2016.

3. Extension of American Samoa economic development credit (sec. 4403 of the bill and sec. 119 of Pub. L. No. 109–432)

PRESENT 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 January 1, 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 taxable years of a corporation that begin after December 31, 2005, and before January 1, 2017.

A corporation was an existing credit claimant with respect to a American Samoa if (1) the corporation was engaged in the active conduct of a trade or business within American Samoa on October

[983] Secs. 7652(a)(3), (b)(3), and (e)(1). One percent of the amount of excise tax collected from imports into the United States of articles produced in the Virgin Islands is retained by the United States under section 7652(b)(3).
[984] Sec. 7652(e)(2).
[985] Secs. 7652(a)(3), (b)(3), and (e)(1).

13, 1995, and (2) the corporation elected the benefits of the possession tax credit[986] in an election in effect for its taxable year that included October 13, 1995.[987] A corporation that added a substantial new line of business (other than in a qualifying acquisition of all the assets of a trade or business of an existing credit claimant) ceased to be an existing credit claimant as of the close of the taxable year ending before the date on which that new line of business was added.

The amount of the credit allowed to a qualifying domestic corporation under the provision is equal to the sum of the amounts used in computing the corporation's economic activity-based limitation with respect to American Samoa, except that no credit is allowed for the amount of any American Samoa income taxes. Thus, for any qualifying corporation the amount of the credit equals the sum of (1) 60 percent of the corporation's qualified American Samoa wages and allocable employee fringe benefit expenses and (2) 15 percent of the corporation's depreciation allowances with respect to short-life qualified American Samoa tangible property, plus 40 percent of the corporation's depreciation allowances with respect to medium-life qualified American Samoa tangible property, plus 65 percent of the corporation's depreciation allowances with respect to long-life qualified American Samoa tangible property.

The section 936(c) rule denying a credit or deduction for any possessions or foreign tax paid with respect to taxable income taken into account in computing the credit under section 936 does not apply with respect to the credit allowed by the provision.

For taxable years beginning after December 31, 2016, the credit rules are modified in two ways. First, domestic corporations with operations in American Samoa are allowed the credit even if those corporations are not existing credit claimants. Second, the credit is available to a domestic corporation (either an existing credit claimant or a new credit claimant) only if, in addition to satisfying all

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[986] For taxable years beginning before January 1, 2006, certain domestic corporations with business operations in the U.S. possessions were eligible for the possession tax credit. Secs. 27(b) and 936. This credit offset the U.S. tax imposed on certain income related to operations in the U.S. possessions. Subject to certain limitations, the amount of the possession tax credit allowed to any domestic corporation equaled the portion of that corporation's U.S. tax that was attributable to the corporation's non-U.S. source taxable income from (1) the active conduct of a trade or business within a U.S. possession, (2) the sale or exchange of substantially all of the assets that were used in such a trade or business, or (3) certain possessions investment. No deduction or foreign tax credit was allowed for any possessions or foreign tax paid or accrued with respect to taxable income that was taken into account in computing the credit under section 936. Under the economic activity-based limit, the amount of the credit could not exceed an amount equal to the sum of (1) 60 percent of the taxpayer's qualified possession wages and allocable employee fringe benefit expenses, (2) 15 percent of depreciation allowances with respect to short-life qualified tangible property, plus 40 percent of depreciation allowances with respect to medium-life qualified tangible property, plus 65 percent of depreciation allowances with respect to long-life qualified tangible property, and (3) in certain cases, a portion of the taxpayer's possession income taxes. A taxpayer could elect, instead of the economic activity-based limit, a limit equal to the applicable percentage of the credit that otherwise would have been allowable with respect to possession business income, beginning in 1998, the applicable percentage was 40 percent.

To qualify for the possession tax credit for a taxable year, a domestic corporation was required to satisfy two conditions. First, the corporation was required to derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation was required to derive at least 75 percent of its gross income for that same period from the active conduct of a possession business. Sec. 936(a)(2). The section 936 credit generally expired for taxable years beginning after December 31, 2005.

[987] A corporation will qualify as an existing credit claimant if it acquired all the assets of a trade or business of a corporation that (1) actively conducted that trade or business in a possession on October 13, 1995, and (2) had elected the benefits of the possession tax credit in an election in effect for the taxable year that included October 13, 1995.

the present law requirements for claiming the credit, the corporation also has qualified production activities income (as defined in section 199(c) by substituting "American Samoa" for "the United States" in each place that latter term appears).

In the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, the credit applies to the first nine taxable years of the corporation which begin after December 31, 2005, and before January 1, 2017. For any other corporation, the credit applies to the first three taxable years of that corporation which begin after December 31, 2011 and before January 1, 2017.

REASON FOR CHANGE

The Committee recognizes the importance of providing incentives to stimulate economic development, create jobs, and fund infrastructure in American Samoa.

EXPLANATION OF PROVISION

The provision extends the credit for five years to apply (a) in the case of a corporation that is an existing credit claimant with respect to American Samoa and that elected the application of section 936 for its last taxable year beginning before January 1, 2006, to the first 17 taxable years of the corporation which begin after December 31, 2005, and before January 1, 2023, and (b) in the case of any other corporation, to the first 11 taxable years of the corporation which begin after December 31, 2011, and before January 1, 2023.

For purposes of this provision, section 119(e) of division A of the Tax Relief and Health Care Act of 2006 [988] is amended to indicate that any reference to section 199 of the Code is to be treated as a reference to section 199 as in effect before its repeal by this bill.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2016.

F. Other International Reforms

1. Restriction on insurance business exception to the passive foreign investment company rules (sec. 4501 of the bill and sec. 1297 of the Code) [989]

REASONS FOR CHANGE

The Committee is concerned about a lack of clarity and precision in the exception to the passive foreign investment company rules for income derived in the active conduct of an insurance business by a corporation that is predominantly engaged in an insurance business. This lack of clarity and precision makes the scope of the exception difficult to ascertain and to enforce. In particular, the Committee is concerned about the lack of precision regarding how

[988] Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, sec. 119.

[989] For a description of present law, see the description in part C.2 above relating to passive foreign investment companies.

much insurance or reinsurance business the company must do to qualify under the exception. The Committee has been informed of offshore arrangements applying the present-law exception that reinsure risks and that invest in U.S. hedge funds, and that have been structured in a manner that raises concerns about the potential for base erosion.[990] The Committee believes that a more mechanical, formulaic rule that is more straightforward to enforce and to apply is appropriate while still preserving the opportunity for a corporation to present facts and circumstances showing it is predominantly engaged in the insurance business, provided the corporation's applicable insurance liabilities are at least 10 percent of its total assets. The Committee also believes that it is important to separately treat different categories of reserves to more accurately determine whether a company meets the insurance exception.

EXPLANATION OF PROVISION

The provision modifies the requirements for a corporation the income of which is not included in passive income for purposes of the PFIC rules. The provision replaces the test based on whether a corporation is predominantly engaged in an insurance business with a test based on the corporation's insurance liabilities.[991] The requirement that the foreign corporation would be subject to tax under subchapter L if it were a domestic corporation is retained.

Under the provision, passive income for purposes of the PFIC rules does not include income derived in the active conduct of an insurance business by a corporation (1) that would be subject to tax under subchapter L if it were a domestic corporation; and (2) the applicable insurance liabilities of which constitute more than 25 percent of its total assets as reported on the company's applicable financial statement for the last year ending with or within the taxable year.

For the purpose of the provision's exception from passive income, applicable insurance liabilities means, with respect to any property and casualty or life insurance business (1) loss and loss adjustment expenses, (2) reserves (other than deficiency, contingency, or un-

[990] The hedge fund reinsurance arrangement is said to provide indefinite deferral of U.S. taxation of the hedge fund's investment earnings, such as interest and dividends. At the time the taxpayer liquidates the investment, ordinary investment earnings are said to be converted to capital gains, which are subject to a lower rate of tax. Press reports have discussed the arrangements. See, e.g., Hal Lux, "The Great Hedge Fund Reinsurance Tax Game," *Institutional Investor,* April 2001, pages 52–58, http://www.institutionalinvestor.com/Article/1027978/The-Great-hedge-fund-reinsurance-tax-ame.html; Steven Davidoff Solomon, "With Lax Regulation, a Risky Industry Flourishes Offshore," Deal Book, *New York Times*, September 4 2012, http://dealbook.nytimes.com/2012/09/04/with-lax-regulation-a-risky-industryflourishes-offshore/?_php=true&_type=blogs&_r=0.

[991] Treasury regulations proposed in 2015 have taken a different approach that is based on the current statutory rule. Prop. Treas. Reg. sec. 1.1297–4, 26 CFR Part 1, REG–108214–15, April 24, 2015. The proposed regulations provide that "the term insurance business means the business of issuing insurance and annuity contracts and the reinsuring of risks underwritten by insurance companies, together with those investment activities and administrative services that are required to support or are substantially related to insurance and annuity contracts issued or reinsured by the foreign corporation." The proposed regulations provide that an investment activity is an activity producing foreign personal holding company income, and that is "required to support or [is] substantially related to insurance and annuity contracts issued or reinsured by the foreign corporation to the extent that income from the activities is earned from assets held by the foreign corporation to meet obligations under the contracts." The preamble to the proposed regulations specifically requests comments on the proposed regulations "with regard to how to determine the portion of a foreign insurance company's assets that are held to meet obligations under insurance contracts issued or reinsured by the company," for example, if the assets "do not exceed a specified percentage of the corporation's total insurance liabilities for the year." *Ibid*.

earned premium reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks. This includes loss reserves for property and casualty, life, and health insurance contracts and annuity contracts. Unearned premium reserves with respect to any type of risk are not treated as applicable insurance liabilities for purposes of the provision. For purposes of the provision, the amount of any applicable insurance liability may not exceed the lesser of such amount (1) as reported to the applicable insurance regulatory body in the applicable financial statement (or, if less, the amount required by applicable law or regulation), or (2) as determined under regulations prescribed by the Secretary.

An applicable financial statement is a statement for financial reporting purposes that (1) is made on the basis of generally accepted accounting principles, (2) is made on the basis of international financial reporting standards, but only if there is no statement made on the basis of generally accepted accounting principles, or (3) except as otherwise provided by the Secretary in regulations, is the annual statement required to be filed with the applicable insurance regulatory body, but only if there is no statement made on either of the foregoing bases. Unless otherwise provided in regulations, it is intended that generally accepted accounting principles means U.S. GAAP.

The applicable insurance regulatory body means, with respect to any insurance business, the entity established by law to license, authorize, or regulate such insurance business and to which the applicable financial statement is provided. For example, in the United States, the applicable insurance regulatory body is the State insurance regulator to which the corporation provides its annual statement.

If a corporation fails to qualify solely because its applicable insurance liabilities constitute 25 percent or less of its total assets, a United States person who owns stock of the corporation may elect in such manner as the Secretary prescribes to treat the stock as stock of a qualifying insurance corporation if (1) the corporation's applicable insurance liabilities constitute at least 10 percent of its total assets, and (2) based on the applicable facts and circumstances, the corporation is predominantly engaged in an insurance business, and its failure to qualify under the 25 percent threshold is due solely to runoff-related or rating-related circumstances involving such insurance business.

Facts and circumstances that tend to show the firm may not be predominantly engaged in an insurance business include a small number of insured risks with low likelihood but large potential costs; workers focused to a greater degree on investment activities than underwriting activities; and low loss exposure. Additional relevant facts for determining whether the firm is predominantly engaged in an insurance business include: claims payment patterns for the current and prior years; the firm's loss exposure as calculated for a regulator such as the SEC or for a rating agency, or if those are not calculated, for internal pricing purposes; the percentage of gross receipts constituting premiums for the current and prior years; and the number and size of insurance contracts issued or taken on through reinsurance by the firm. The fact that a firm has been holding itself out as an insurer for a long period is not determinative either way.

Runoff-related or rating-related circumstances include, for example, the fact that the company is in runoff, that is, it is not taking on new insurance business (and consequently has little or no premium income), and is using its remaining assets to pay off claims with respect to pre-existing insurance risks on its books. Such circumstances also include, for example, the application to the company of specific requirements with respect to capital and surplus relating to insurance liabilities imposed by a rating agency as a condition of obtaining a rating necessary to write new insurance business for the current year.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 2017.

TITLE V—EXEMPT ORGANIZATIONS

A. UNRELATED BUSINESS INCOME TAX

1. Clarification of unrelated business income tax treatment of entities exempt from tax under section 501(a) (sec. 5001 of the bill and sec. 511 of the Code)

PRESENT LAW

Tax exemption for certain organizations

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

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

Unrelated business income tax, in general

An exempt organization generally may have revenue from four sources: contributions, gifts, and grants; trade or business income that is related to exempt activities (*e.g.,* program service revenue); investment income; and trade or business income that is not related to exempt activities. The Federal income tax exemption generally extends to the first three categories, and does not extend to an organization's unrelated trade or business income. In some cases, however, the investment income of an organization is taxed as if it were unrelated trade or business income.[992]

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[993] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990–T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[994] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and certain charitable trusts);[995] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[996] and (3) certain State colleges and universities.[997]

REASONS FOR CHANGE

The Committee believes it is necessary and desirable to clarify the applicability of the UBIT rules to certain tax-exempt organizations. The UBIT rules, by their express terms, apply to most organizations described in section 401(a) and 501(c) and do not exclude section 115 organizations that are also described in section 401(a) or 501(c). The Committee understands, however, that certain organizations (such as State pension funds) that are described in section 401(a) or 501(c) of the Code take the position that they are not subject to UBIT because their income is derived from the exercise of an essential government function as described in section 115 of the Code. This provision clarifies that organizations with income described in section 115 are not exempt from application of the UBIT rules.

EXPLANATION OF PROVISION

The provision clarifies that an organization does not fail to be subject to tax on its unrelated business income as an organization exempt from tax under section 501(a) solely because the organiza-

[992] This is the case for social clubs (sec. 501(c)(7)), voluntary employees' beneficiary associations (sec. 501(c)(9)), and organizations and trusts described in sections 501(c)(17) and 501(c)(20). Sec. 512(a)(3).
[993] Secs. 511–514.
[994] Treas. Reg. sec. 1.501(c)(3)–1(e).
[995] Sec. 511(a)(2)(A).
[996] Sec. 511(a)(2)(A).
[997] Sec. 511(a)(2)(B).

tion also is exempt, or excludes amounts from gross income, by reason of another provision of the Code. For example, if an organization is described in section 401(a) (and thus is exempt from tax under section 501(a)) and its income also is described in section 115 (relating to the exclusion from gross income of certain income derived from the exercise of an essential governmental function), its status under section 115 does not cause it to be exempt from tax on its unrelated business income.

EFFECTIVE DATE

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

2. Exclusion of research income from unrelated business taxable income limited to publicly available research (sec. 5002 of the bill and sec. 512(b)(9) of the Code)

PRESENT LAW

Tax exemption for certain organizations

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

Unrelated business income tax, in general

The unrelated business income tax ("UBIT") generally applies to income derived from a trade or business regularly carried on by the organization that is not substantially related to the performance of the organization's tax-exempt functions.[998] An organization that is subject to UBIT and that has $1,000 or more of gross unrelated business taxable income must report that income on Form 990–T (Exempt Organization Business Income Tax Return).

Most exempt organizations may operate an unrelated trade or business so long as the organization remains primarily engaged in activities that further its exempt purposes. Therefore, an organization may engage in a substantial amount of unrelated business activity without jeopardizing exempt status. A section 501(c)(3) (charitable) organization, however, may not operate an unrelated trade or business as a substantial part of its activities.[999] Therefore, the unrelated trade or business activity of a section 501(c)(3) organization must be insubstantial.

Organizations subject to tax on unrelated business income

Most exempt organizations are subject to the tax on unrelated business income. Specifically, organizations subject to the unrelated business income tax generally include: (1) organizations exempt from tax under section 501(a), including organizations described in section 501(c) (except for U.S. instrumentalities and cer-

[998] Secs. 511–514.
[999] Treas. Reg. sec. 1.501(c)(3)–1(e).

tain charitable trusts);[1000] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1001] and (3) certain State colleges and universities.[1002]

Exclusions from unrelated business taxable income

In general

Certain types of income are specifically exempt from unrelated business taxable income, such as dividends, interest, royalties, and certain rents,[1003] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[1004] Other exemptions from UBIT are provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special UBIT provisions exempt from tax activities of trade shows and State fairs, income from bingo games, and income from the distribution of low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Research income

Certain income derived from research activities of exempt organizations is excluded from unrelated business taxable income. For example, income derived from research performed for the United States, a State, and certain agencies and subdivisions is excluded.[1005] Income from research performed by a college, university, or hospital for any person also is excluded.[1006] Finally, if an organization is operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public, all income derived by research performed by such organization for any person, not just income derived from research available to the general public, is excluded.[1007]

REASONS FOR CHANGE

The Committee believes it is desirable to carefully tailor the exclusions from the UBIT rules to better encourage tax-exempt organizations to engage in fundamental research the results of which are made available to the general public.

EXPLANATION OF PROVISION

The provision modifies the exclusion of income from research performed by an organization operated primarily for purposes of carrying on fundamental research the results of which are freely available to the general public (section 512(b)(9)). Under the provision, the organization may exclude from unrelated business taxable in-

[1000] Sec. 511(a)(2)(A).
[1001] Sec. 511(a)(2)(A).
[1002] Sec. 511(a)(2)(B).
[1003] Secs. 511–514.
[1004] Sec. 512(b)(13).
[1005] Sec. 512(b)(7).
[1006] Sec. 512(b)(8).
[1007] Sec. 512(b)(9).

come under section 512(b)(9) only income from such fundamental research the results of which are freely available to the general public.

EFFECTIVE DATE

The proposal is effective for taxable years beginning after December 31, 2017.

B. EXCISE TAXES

1. Simplification of excise tax on private foundation investment income (sec. 5101 of the bill and sec. 4940 of the Code)

PRESENT LAW

Excise tax on the net investment income of private foundations

Under section 4940(a), private foundations that are recognized as exempt from Federal income tax under section 501(a) (other than exempt operating foundations[1008]) are subject to a two-percent excise tax on their net investment income. Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[1009] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[1010] In addition, the foundation cannot have been subject to tax in any of the five preceding years for failure to meet minimum qualifying distribution requirements in section 4942.

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has

[1008] Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

[1009] Sec. 4942(g).

[1010] Sec. 4940(e).

to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[1011]

REASONS FOR CHANGE

Under the present-law, two-tier private foundation excise tax rate structure, a foundation must carefully manage the timing and amount of its grant making to minimize its excise tax burden. Compliance can be costly and consume resources that otherwise would have been used for grant making or other charitable activity.

In addition, to qualify for the lower tax rate in a year, a foundation must ensure that its distributions for the year exceed a historical, average level of distributions. This structure creates an incentive for foundations to limit distributions in any one year, because a significant increase in distributions will raise the foundation's average level of distributions, making it more difficult to qualify for the reduced rate in future years. As a result, a foundation that might have been inclined to distribute a larger amount in a time of public need, such as during the response to a natural disaster, has a disincentive to do so.

For these reasons, the Committee believes it is appropriate to replace the present-law, two-tier private foundation excise tax rate structure with a simplified structure that uses a single tax rate of 1.4 percent.

EXPLANATION OF PROVISION

The provision replaces the two rates of excise tax on tax-exempt private foundations with a single rate of tax of 1.4 percent. Thus, under the provision, a tax-exempt private foundation generally is subject to an excise tax of 1.4 percent on its net investment income. A taxable private foundation is subject to an excise tax equal to the excess (if any) of the sum of the 1.4 percent net investment income excise tax and the amount of the tax on unrelated business income (both calculated as if the foundation were tax-exempt), over the income tax imposed on the foundation. The provision repeals the special reduced excise tax rate for private foundations that exceed their historical level of qualifying distributions.

EFFECTIVE DATE

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

2. Private operating foundation requirements relating to operation of an art museum (sec. 5102 of the bill and sec. 4942(j) of the Code)

PRESENT LAW

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[1012] Certain organizations are classified as public char-

[1011] Sec. 4942(d)(2).

[1012] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

ities *per se*, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations, certain organizations providing assistance to colleges and universities, and governmental units.[1013] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants, or other contributions from governmental units or the general public.[1014] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (e.g., fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[1015] A supporting organization, *i.e.,* an organization that provides support to another section 501(c)(3) entity that is not a private foundation and meets certain other requirements of the Code, also is classified as a public charity.[1016]

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (e.g., an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities.[1017]

Tax on failure to distribute income by private nonoperating foundations

Private nonoperating foundations are required to pay out a minimum amount each year as qualifying distributions.[1018] In general, a qualifying distribution is an amount paid to accomplish one or

[1013] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[1014] Treas. Reg. sec. 1.170A–9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A–9(f)(3).

[1015] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

[1016] Sec. 509(a)(3). Supporting organizations are further classified as Type I, II, or III depending on the relationship they have with the organizations they support. Supporting organizations must support public charities listed in one of the other categories (*i.e., per se* public charities, broadly supported public charities, or revenue generating public charities), and they are not permitted to support other supporting organizations or testing for public safety organizations.

Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

[1017] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year, (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

[1018] Sec. 4942.

more of the organization's exempt purposes, including reasonable and necessary administrative expenses.[1019] Failure to pay out the minimum required amount results in an initial excise tax on the foundation of 30 percent of the undistributed amount. An additional tax of 100 percent of the undistributed amount applies if an initial tax is imposed and the required distributions have not been made by the end of the applicable taxable period.[1020] A foundation may include as a qualifying distribution the salaries, occupancy expenses, travel costs, and other reasonable and necessary administrative expenses that the foundation incurs in operating a grant program. A qualifying distribution also includes any amount paid to acquire an asset used (or held for use) directly in carrying out one or more of the organization's exempt purposes and certain amounts set aside for exempt purposes.[1021]

Private operating foundations

The tax on failure to distribute income does not apply to the undistributed income of a private foundation for any taxable year for which it is an operating foundation.[1022] Private operating foundations generally operate their own charitable programs directly, rather than serving primarily as a grantmaking entity.

Private operating foundations must satisfy several tests designed to distinguish them from nonoperating (grantmaking) foundations. First, an operating foundation generally must make qualifying distributions for the direct conduct of activities that are related to its exempt purpose (as opposed to making such distributions in the form of grants to other charities) equal to 85 percent of the lesser of its adjusted net income or its minimum investment return, each as defined under section 4942.[1023] In addition, an operating foundation must satisfy one of the following three alternative tests: (1) an asset test, under which substantially more than half of the organization's assets (generally, 65 percent) are devoted to the direct conduct of exempt activities or to functionally related businesses; (2) an endowment test, under which the organization normally makes qualifying distributions for the direct conduct of activities related to its exempt purpose in an amount not less than two-thirds of its minimum investment return; or (3) a support test, under which the organization must meet certain measures to show that it receives public support.[1024]

REASONS FOR CHANGE

Because private operating foundations run their own charitable programs (rather than serving primarily as grant makers to operating charities), private operating foundations are given preferential treatment under Code. It has come to the attention of the Committee, however, that certain private operating foundations that operate art museums severely restrict public access to their

[1019] Sec. 4942(g)(1)(A).
[1020] Sec. 4942(a) and (b). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.
[1021] Sec. 4942(g)(1)(B) and 4942(g)(2). In general, an organization is permitted to adjust the distributable amount in those cases where distributions during the five preceding years have exceeded the payout requirements. Sec. 4942(i).
[1022] Sec. 4942(a)(1).
[1023] Sec. 4942(j)(3)(A); Treas. Reg. sec. 53.4942(b)–1(c).
[1024] Sec. 4942(j)(3)(B).

collections, raising the question whether the museums are operated for a public or a private purpose. For this reason, the Committee believes that an organization that operates an art museum as a substantial activity should not qualify for private operating foundation status unless it offers meaningful access to the public during normal business hours.

EXPLANATION OF PROVISION

Under the provision, an organization that operates an art museum as a substantial activity does not qualify as a private operating foundation unless the museum is open during normal business hours to the public for at least 1,000 hours during the taxable year.

EFFECTIVE DATE

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

3. Excise tax based on investment income of private colleges and universities (sec. 5103 of the bill and new sec. 4969 of the Code)

PRESENT LAW

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[1025] Certain organizations are classified as public charities *per se,* regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations, certain organizations providing assistance to colleges and universities, and governmental units.[1026] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants, or other contributions from governmental units or the general public.[1027] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (e.g., fee for service income). In addition, this category of public charity must not rely excessively on endowment income as a source of support.[1028] A supporting organization, *i.e.,* an organization that provides support to another section 501(c)(3) entity that is not a pri-

[1025] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[1026] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[1027] Treas. Reg. sec. 1.170A–9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A–9(f)(3).

[1028] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

vate foundation and meets the requirements of the Code, also is classified as a public charity.[1029]

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.,* an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities.[1030]

Excise tax on investment income of private foundations

Under section 4940(a), private foundations that are recognized as exempt from Federal income tax under section 501(a) (other than exempt operating foundations)[1031] are subject to a two-percent excise tax on their net investment income. Net investment income generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, and is reduced by expenses incurred to earn this income. The two-percent rate of tax is reduced to one-percent in any year in which a foundation exceeds the average historical level of its charitable distributions. Specifically, the excise tax rate is reduced if the foundation's qualifying distributions (generally, amounts paid to accomplish exempt purposes)[1032] equal or exceed the sum of (1) the amount of the foundation's assets for the taxable year multiplied by the average percentage of the foundation's qualifying distributions over the five taxable years immediately preceding the taxable year in question, and (2) one percent of the net investment income of the foundation for the taxable year.[1033] In addition, the foundation cannot have been subject to tax in any of the five preceding years for failure to

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[1029] Sec. 509(a)(3). Supporting organizations are further classified as Type I, II, or III depending on the relationship they have with the organizations they support. Supporting organizations must support public charities listed in one of the other categories (*i.e., per se* public charities, broadly supported public charities, or revenue generating public charities), and they are not permitted to support other supporting organizations or testing for public safety organizations.

Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

[1030] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year, (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers of the foundation.

[1031] Exempt operating foundations are exempt from the section 4940 tax. Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

[1032] Sec. 4942(g).

[1033] Sec. 4940(e).

[1034] Under a separate provision, the private foundation excise tax would be simplified by replacing the two-tier rate structure with a single-rate tax set at 1.4 percent.

meet minimum qualifying distribution requirements in section 4942.[1034]

Private foundations that are not exempt from tax under section 501(a), such as certain charitable trusts, are subject to an excise tax under section 4940(b). The tax is equal to the excess of the sum of the excise tax that would have been imposed under section 4940(a) if the foundation were tax exempt and the amount of the tax on unrelated business income that would have been imposed if the foundation were tax exempt, over the income tax imposed on the foundation under subtitle A of the Code.

Private foundations are required to make a minimum amount of qualifying distributions each year to avoid tax under section 4942. The minimum amount of qualifying distributions a foundation has to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[1035]

Private colleges and universities

Private colleges and universities generally are treated as public charities rather than private foundations[1036] and thus are not subject to the private foundation excise tax on net investment income.

REASONS FOR CHANGE

In recent years, the endowment balances at many private colleges and universities have increased dramatically. At the same time, college tuition has risen at rates in excess of the rate of inflation. Where the endowment of a private college or university has grown so large that it is not commensurate with the scope of the institution's activities in educating students, the Committee believes it is appropriate to impose a modest excise tax on the investment income derived from the endowment.

EXPLANATION OF PROVISION

The provision imposes an excise tax on an applicable educational institution for each taxable year equal to 1.4 percent of the net investment income of the institution for the taxable year. Net investment income is determined using rules similar to the rules of section 4940(c) (relating to the net investment income of a private foundation).

For purposes of the provision, an applicable educational institution is an institution: (1) that has at least 500 students during the preceding taxable year; (2) that is an eligible education institution as described in section 25A of the Code;[1037] (3) that is not described in the first section of section 511(a)(2)(B) of the Code (generally describing State colleges and universities); and (4) the aggregate fair market value of the assets of which at the end of the pre-

[1031] Exempt operating foundations are exempt from the section 4940 tax. Sec. 4940(d)(1). Exempt operating foundations generally include organizations such as museums or libraries that devote their assets to operating charitable programs but have difficulty meeting the "public support" tests necessary not to be classified as a private foundation. To be an exempt operating foundation, an organization must: (1) be an operating foundation (as defined in section 4942(j)(3)); (2) be publicly supported for at least 10 taxable years; (3) have a governing body no more than 25 percent of whom are disqualified persons and that is broadly representative of the general public; and (4) have no officers who are disqualified persons. Sec. 4940(d)(2).

[1032] Sec. 4942(g).

[1033] Sec. 4940(e).

[1034] Under a separate provision, the private foundation excise tax would be simplified by replacing the two-tier rate structure with a single-rate tax set at 1.4 percent.

ceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose)[1038] is at least $250,000 per student. For these purposes, the number of students of an institution is based on the daily average number of full-time students attending the institution, with part-time students being taken into account on a full-time student equivalent basis.

For purposes of determining whether an institution meets the asset-per-student threshold and determining net investment income, assets and net investment income include amounts with respect to an organization that is related to the institution. An organization is treated as related to the institution for this purpose if the organization: (1) controls, or is controlled by, the institution; (2) is controlled by one or more persons that control the institution; or (3) is a supported organization[1039] or a supporting organization[1040] during the taxable year with respect to the institution.

EFFECTIVE DATE

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

4. Provide an exception to the private foundation excess business holdings rules for philanthropic business holdings (sec. 5104 of the bill and sec. 4943 of the Code)

PRESENT LAW

Public charities and private foundations

An organization qualifying for tax-exempt status under section 501(c)(3) is further classified as either a public charity or a private foundation. An organization may qualify as a public charity in several ways.[1041] Certain organizations are classified as public charities per se, regardless of their sources of support. These include churches, certain schools, hospitals and other medical organizations (including medical research organizations), certain organizations providing assistance to colleges and universities, and governmental units.[1042] Other organizations qualify as public charities because they are broadly publicly supported. First, a charity may qualify as publicly supported if at least one-third of its total support is from gifts, grants, or other contributions from governmental units or the general public.[1043] Alternatively, it may qualify as publicly supported if it receives more than one-third of its total support from a combination of gifts, grants, and contributions from governmental units and the public plus revenue arising from activities related to its exempt purposes (e.g., fee for service income). In addition, this

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[1037] Section 25A defines an eligible educational institution as an institution (1) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. sec. 1088), as in effect on August 5, 1977, and (2) which is eligible to participate in a program under title IV of such Act.

[1038] Assets used directly in carrying out the institution's exempt purpose include, for example, classroom buildings and physical facilities used for educational activities and office equipment or other administrative assets used by employees of the institution in carrying out exempt activities, among other assets. 1039 Secs. 509(f)(3). 1040 Secs. 509(a)(3).

[1039] Secs. 509(f)(3).

[1040] Secs. 509(a)(3).

[1041] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[1042] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

category of public charity must not rely excessively on endowment income as a source of support.[1044] A supporting organization, i.e., an organization that provides support to another section 501(c)(3) entity that is not a private foundation and meets certain other requirements of the Code, also is classified as a public charity.[1045]

A section 501(c)(3) organization that does not fit within any of the above categories is a private foundation. In general, private foundations receive funding from a limited number of sources (*e.g.*, an individual, a family, or a corporation).

The deduction for charitable contributions to private foundations is in some instances less generous than the deduction for charitable contributions to public charities. In addition, private foundations are subject to a number of operational rules and restrictions that do not apply to public charities, as well as a tax on their net investment income.[1046]

Excess business holdings of private foundations

Private foundations are subject to tax on excess business holdings.[1047] In general, a private foundation is permitted to hold 20 percent of the voting stock in a corporation, reduced by the amount of voting stock held by all disqualified persons (as defined in section 4946). If it is established that no disqualified person has effective control of the corporation, a private foundation and disqualified persons together may own up to 35 percent of the voting stock of a corporation. A private foundation shall not be treated as having excess business holdings in any corporation if it owns (together with certain other related private foundations) not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of stock in that corporation. Similar rules apply with respect to holdings in a partnership (substituting "profits interest" for "voting stock" and "capital interest" for "nonvoting stock") and to other unincorporated enterprises (by substituting "beneficial interest" for "voting stock"). Private foundations are not permitted to have holdings in a proprietorship. Foundations generally have a five-year period to dispose of excess business holdings (acquired other than by purchase) without being subject to tax.[1048] This five-year period may be extended an additional five years in limited circumstances.[1049] The excess business holdings rules do not apply to holdings in a functionally related business or to holdings in a trade or business at least 95 percent of the gross income of which is derived from passive sources.[1050]

[1043] Treas. Reg. sec. 1.170A–9(f)(2). Failing this mechanical test, the organization may qualify as a public charity if it passes a "facts and circumstances" test. Treas. Reg. sec. 1.170A–9(f)(3).

[1044] To meet this requirement, the organization must normally receive more than one-third of its support from a combination of (1) gifts, grants, contributions, or membership fees and (2) certain gross receipts from admissions, sales of merchandise, performance of services, and furnishing of facilities in connection with activities that are related to the organization's exempt purposes. Sec. 509(a)(2)(A). In addition, the organization must not normally receive more than one-third of its public support in each taxable year from the sum of (1) gross investment income and (2) the excess of unrelated business taxable income as determined under section 512 over the amount of unrelated business income tax imposed by section 511. Sec. 509(a)(2)(B).

[1045] Sec. 509(a)(3). Organizations organized and operated exclusively for testing for public safety also are classified as public charities. Sec. 509(a)(4). Such organizations, however, are not eligible to receive deductible charitable contributions under section 170.

[1046] Unlike public charities, private foundations are subject to tax on their net investment income at a rate of two percent (one percent in some cases). Sec. 4940. Private foundations also are subject to more restrictions on their activities than are public charities. For example, private foundations are prohibited from engaging in self-dealing transactions (sec. 4941), are required to make a minimum amount of charitable distributions each year (sec. 4942), are limited in the extent to which they may control a business (sec. 4943), may not make speculative investments (sec. 4944), and may not make certain expenditures (sec. 4945). Violations of these rules result in excise taxes on the foundation and, in some cases, may result in excise taxes on the managers

The initial tax is equal to five percent of the value of the excess business holdings held during the foundation's applicable taxable year. An additional tax is imposed if an initial tax is imposed and at the close of the applicable taxable period, the foundation continues to hold excess business holdings. The amount of the additional tax is equal to 200 percent of such holdings.

REASONS FOR CHANGE

In recent years, a new type of philanthropy has combined private sector entrepreneurship with charitable giving, such as through the donation of a private company's after-tax profits to charity. The Committee believes it is appropriate to encourage this form of philanthropy by eliminating certain legal impediments to its use, while also ensuring that private individuals cannot improperly benefit from amounts intended for a charitable purpose or inappropriately manage a taxable business. The Committee therefore believes it is appropriate to create an exception to the present-law private foundation excess business holdings rules for certain philanthropic business holdings. By so doing, the law will permit private philanthropists to bequeath an entire business to a private foundation, provided that the after-tax profits of the business will be paid to the foundation and certain other requirements are satisfied, while also ensuring that the donor's heirs cannot improperly benefit from the arrangement.

EXPLANATION OF PROVISION

The provision creates an exception to the excess business holdings rules for certain philanthropic business holdings. Specifically, the tax on excess business holdings does not apply with respect to the holdings of a private foundation in any business enterprise that, for the taxable year, satisfies the following requirements: (1) the ownership requirements; (2) the "all profits to charity" distribution requirement; and (3) the independent operation requirements.

The ownership requirements are satisfied if: (1) all ownership interests in the business enterprise are held by the private foundation at all times during the taxable year; and (2) all the private foundation's ownership interests in the business enterprise were acquired not by purchase.

The "all profits to charity" distribution requirement is satisfied if the business enterprise, not later than 120 days after the close of the taxable year, distributes an amount equal to its net operating income for such taxable year to the private foundation. For this purpose, the net operating income of any business enterprise for any taxable year is an amount equal to the gross income of the business enterprise for the taxable year, reduced by the sum of: (1) the deductions allowed by chapter 1 of the Code for the taxable year that are directly connected with the production of the income; (2) the tax imposed by chapter 1 on the business enterprise for the taxable year; and (3) an amount for a reasonable reserve for working capital and other business needs of the business enterprise.

The independent operation requirements are met if, at all times during the taxable year, the following three requirements are satisfied. First, no substantial contributor to the private foundation, or family member of such a contributor, is a director, officer, trustee, manager, employee, or contractor of the business enterprise (or an individual having powers or responsibilities similar to any of the foregoing). Second, at least a majority of the board of directors of the private foundation are not also directors or officers of the business enterprise or members of the family of a substantial contributor to the private foundation. Third, there is no loan outstanding from the business enterprise to a substantial contributor to the private foundation or a family member of such contributor. For purposes of the independent operation requirements, "substantial contributor" has the meaning given to the term under section 4958(c)(3)(C), and family members are determined under section 4958(f)(4).

The provision does not apply to the following organizations: (1) donor advised funds or supporting organizations that are subject to the excess business holdings rules by reason of section 4943(e) or (f); (2) any trust described in section 4947(a)(1) (relating to charitable trusts); or (3) any trust described in section 4947(a)(2) (relating to split-interest trusts).

EFFECTIVE DATE

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

C. Requirements for Organizations Exempt From Tax

1. Section 501(c)(3) organizations permitted to make statements relating to political campaign in ordinary course of activities in carrying out exempt purpose (sec. 5201 of the bill and sec. 501 of the Code)

PRESENT LAW

Section 501(c)(3) organizations

Charitable organizations, *i.e.*, organizations described in section 501(c)(3), generally are exempt from Federal income tax and are eligible to receive tax deductible contributions. A charitable organization must operate primarily in pursuance of one or more tax-exempt purposes constituting the basis of its tax exemption.[1051] The Code specifies such purposes as religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster international amateur sports competition, or for the prevention of cruelty to children or animals.[1052] In general, an organization is organized and operated for charitable purposes if it provides relief for the poor and distressed or the underprivileged. In order to qualify as operating primarily for a purpose described in section 501(c)(3), an organization must satisfy the following operational requirements: (1) its net earnings may not inure to the benefit of any person in a position to influence the activities of the organization; (2) it must operate to provide a public benefit, not a private benefit;[1053] (3) it may not be operated primarily to conduct an unrelated trade or business;[1054] (4) it may not engage in substantial

[1051] Treas. Reg. sec. 1.501(c)(3)–1(c)(1).
[1052] Treas. Reg. sec. 1.501(c)(3)–1(d)(2).
[1053] Treas. Reg. sec. 1.501(c)(3)–1(d)(1)(ii).
[1054] Treas. Reg. sec. 1.501(c)(3)–1(e)(1). Conducting a certain level of unrelated trade or business activity will not jeopardize tax-exempt status.

legislative lobbying; and (5) it may not participate or intervene in any political campaign.

Section 501(c)(3) organizations are classified either as "public charities" or "private foundations."[1055] Private foundations generally are defined under section 509(a) as all organizations described in section 501(c)(3) other than an organization granted public charity status by reason of: (1) being a specified type of organization (*i.e.*, churches, educational institutions, hospitals and certain other medical organizations, certain organizations providing assistance to colleges and universities, or a governmental unit); (2) receiving a substantial part of its support from governmental units or direct or indirect contributions from the general public; or (3) providing support to another section 501(c)(3) entity that is not a private foundation. In contrast to public charities, private foundations generally are funded from a limited number of sources (*e.g.*, an individual, family, or corporation). Donors to private foundations and persons related to such donors together often control the operations of private foundations.

Because private foundations receive support from, and typically are controlled by, a small number of supporters, private foundations are subject to a number of anti-abuse rules and excise taxes not applicable to public charities.[1056] Public charities also have certain advantages over private foundations regarding the deductibility of contributions.

Political campaign activities

Charitable organizations may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.[1057] The prohibition on such political campaign activity is absolute and, in general, includes activities such as making contributions to a candidate's political campaign, endorsements of a candidate, lending employees to work in a political campaign, or providing facilities for use by a candidate. The absolute prohibition on campaign activities was added in 1954 by the so called "Johnson amendment."[1058] Many other activities may constitute political campaign activity, depending on the facts and circumstances. The sanction for a violation of the prohibition is loss of the organization's tax-exempt status.

For organizations that engage in prohibited political campaign activity, the Code provides three penalties that may be applied either as alternatives to revocation of tax exemption or in addition to loss of tax-exempt status: an excise tax on political expenditures,[1059] termination assessment of all taxes due,[1060] and an injunction against further political expenditures.[1061]

REASONS FOR CHANGE

The Committee believes that the Johnson amendment's prohibition on the making of candidate-related statements creates an

[1055] Sec. 509(a).
[1056] Secs. 4940–4945.
[1057] Sec. 501(c)(3).
[1058] Internal Revenue Code of 1954, sec. 501(c)(3), Pub. L. No. 591 (August 16, 1954).
[1059] Sec. 4955.
[1060] Sec. 6852(a)(1).
[1061] Sec. 7409.

undue chilling effect on free speech by curtailing charity employees'—including ministers' and other religious leaders'—expression of their political opinions. The Committee therefore believes that the restriction should be modified to permit charities to engage in certain candidate-related speech in the course of their exempt activities in a manner that would not fundamentally change the nature of what makes them charities under the Code.

EXPLANATION OF PROVISION

The provision modifies the present-law rules relating to political campaign activity by section 501(c)(3) organizations for the following purposes: (1) section 501(c)(3) tax-exempt status; (2) qualifying as an eligible recipient of tax-deductible contributions for income,[1062] gift,[1063] and estate tax[1064] purposes; and (3) application of the excise tax on political expenditures by section 501(c)(3) organizations.[1065]

For such purposes, an organization shall not fail to be treated as organized and operated exclusively for a purpose described in section 501(c)(3), nor shall it be deemed to have participated in, or intervened in any political campaign on behalf of (or in opposition to) any candidate for public office, solely because of the content of any statement that: (A) is made in the ordinary course of the organization's regular and customary activities in carrying out its exempt purpose; and (B) results in the organization incurring not more than *de minimis* incremental expenses.

The provision does not apply to taxable years beginning after December 31, 2023.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2018.

2. Additional reporting requirements for donor advised fund sponsoring organizations (sec. 5202 of the bill and sec. 6033 of the Code)

PRESENT LAW

Overview

Some charitable organizations (including community foundations) 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 for maintenance in a donor advised fund generally claim a charitable contribution deduction at the time of the contribution.[1066] Although sponsoring char-

[1062] Sec. 170(c)(2).
[1063] Sec. 2522.
[1064] Secs. 2055 and 2106.
[1065] Sec. 4955.
[1066] Contributions to a sponsoring organization for maintenance in a donor advised fund are not eligible for a charitable deduction for income tax purposes if the sponsoring organization is a veterans' organization described in section 170(c)(3), a fraternal society described in section 170(c)(4), or a cemetery company described in section 170(c)(5); for gift tax purposes if the sponsoring organization is a fraternal society described in section 2522(a)(3) or a veterans' organization described in section 2522(a)(4); or for estate tax purposes if the sponsoring organization is

ities frequently permit donors (or other persons appointed by donors) to provide nonbinding recommendations concerning the distribution or investment of assets in a donor advised fund, sponsoring charities generally must have legal ownership and control of such assets following the contribution. If the sponsoring charity does not have such control (or permits a donor to exercise control over amounts contributed), the donor's contributions may not qualify for a charitable deduction, and, in the case of a community foundation, the contribution may be treated as being subject to a material restriction or condition by the donor.

Statutory definition of a donor advised fund

The Code defines a "donor advised fund" as a fund or account that is: (1) separately identified by reference to contributions of a donor or donors; (2) owned and controlled by a sponsoring organization; and (3) with respect to which a donor (or any person appointed or designated by such donor (a "donor advisor")) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the separately identified fund or account by reason of the donor's status as a donor. All three prongs of the definition must be met in order for a fund or account to be treated as a donor advised fund.[1067]

A "sponsoring organization" is an organization that: (1) is described in section 170(c)[1068] (other than a governmental entity described in section 170(c)(1), and without regard to any requirement that the organization be organized in the United States[1069]); (2) is not a private foundation (as defined in section 509(a)); and (3) maintains one or more donor advised funds.[1070]

Reporting and disclosure

Each sponsoring organization must disclose on its information return: (1) the total number of donor advised funds it owns; (2) the aggregate value of assets held in those funds at the end of the organization's taxable year; and (3) the aggregate contributions to and grants made from those funds during the year.[1071] In addition, when seeking recognition of its tax-exempt status, a sponsoring or-

a fraternal society described in section 2055(a)(3) or a veterans' organization described in section 2055(a)(4). In addition, contributions to a sponsoring organization for maintenance in a donor advised fund are not eligible for a charitable deduction for income, gift, or estate tax purposes if the sponsoring organization is a Type III supporting organization (other than a functionally integrated Type III supporting organization). In addition to satisfying generally applicable substantiation requirements under section 170(f), a donor must obtain, with respect to each charitable contribution to a sponsoring organization to be maintained in a donor advised fund, a contemporaneous written acknowledgment from the sponsoring organization providing that the sponsoring organization has exclusive legal control over the assets contributed.

[1067] See sec. 4966(d)(2)(A). A donor advised fund does not include a fund or account that makes distributions only to a single identified organization or governmental entity. A donor advised fund also does not include certain funds or accounts with respect to which a donor or donor advisor provides advice as to which individuals receive grants for travel, study, or other similar purposes. In addition, the Secretary may exempt a fund or account from treatment as a donor advised fund if such fund or account is advised by a committee not directly or indirectly controlled by a donor, donor advisor, or persons related to a donor or donor advisor. The Secretary also may exempt a fund or account from treatment as a donor advised fund if such fund or account benefits a single identified charitable purpose. Secs. 4966(d)(2)(B) and (C).

[1068] Section 170(c) describes organizations to which charitable contributions that are deductible for income tax purposes can be made.

[1069] See sec. 170(c)(2)(A).

[1070] Sec. 4966(d)(1).

[1071] Sec. 6033(k).

ganization must disclose whether it intends to maintain donor advised funds.[1072]

REASONS FOR CHANGE

Organizations that sponsor donor advised funds are now among the largest charities in the United States. To better understand the operations of donor advised funds and to enhance public oversight of the tax-exempt sector, the Committee believes it is in the interest of the public and policymakers to require sponsoring organizations to report on their annual information returns additional information regarding levels of grant making from donor advised funds and policies implemented by the sponsoring organization relating to distributions from donor advised funds.

EXPLANATION OF PROVISION

The provision requires a sponsoring organization to report additional information on its annual information return (Form 990). Sponsoring organizations must indicate: (1) the average amount of grants made from donor advised funds during the taxable year (expressed as a percentage of the value of assets held in such funds at the beginning of the taxable year), and (2) whether the organization has a policy with respect to donor advised funds relating to the frequency and minimum level of distributions from donor advised funds. The sponsoring organization must include with its return a copy of any such policy.

EFFECTIVE DATE

The provision is effective for returns filed for taxable years beginning after December 31, 2017.

III. VOTES OF THE COMMITTEE

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 6, 2017.

The vote on Mr. Doggett's motion to postpone consideration of H.R. 1 was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....
Mr. Buchanan	....	X	....	Mr. Blumenauer	X	....	....
Mr. Smith (NE)	....	X	....	Mr. Kind	X	....	....
Ms. Jenkins	....	X	....	Mr. Pascrell	X	....	....
Mr. Paulsen	....	X	....	Mr. Crowley	X	....	....
Mr. Marchant	....	X	....	Mr. Davis	X	....	....
Ms. Black	....	X	....	Ms. Sanchez	X	....	....
Mr. Reed	....	X	....	Mr. Higgins	X	....	....
Mr. Kelly	....	X	....	Ms. Sewell	X	....	....
Mr. Renacci	....	X	....	Ms. DelBene	X	....	....

[1072] Sec. 508(f).

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Meehan	....	X	....	Ms. Chu	X	....	....
Ms. Noem	....	X	....				
Mr. Holding	....	X	....				
Mr. Smith (MO)	....	X	....				
Mr. Rice	....	X	....				
Mr. Schweikert	....	X	....				
Ms. Walorski	....	X	....				
Mr. Curbelo	....	X	....				
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 6, 2017.

The vote on the amendment offered by Mr. Brady to the amendment in the nature of a substitute to H.R. 1, which would make modifications to several tax provisions including administration of the earned income tax credit program, the exclusion from gross income for dependent care assistance, the tax on investment income on endowments, the tax treatment of musical compositions, stock option compensation, carried interest, and the rules on international base erosion, was agreed to by a roll call vote of 24 yeas to 16 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	X	....	....	Mr. Neal	....	X	....
Mr. Johnson	X	....	....	Mr. Levin	....	X	....
Mr. Nunes	X	....	....	Mr. Lewis	....	X	....
Mr. Tiberi	X	....	....	Mr. Doggett	....	X	....
Mr. Reichert	X	....	....	Mr. Thompson	....	X	....
Mr. Roskam	X	....	....	Mr. Larson	....	X	....
Mr. Buchanan	X	....	....	Mr. Blumenauer	....	X	....
Mr. Smith (NE)	X	....	....	Mr. Kind	....	X	....
Ms. Jenkins	X	....	....	Mr. Pascrell	....	X	....
Mr. Paulsen	X	....	....	Mr. Crowley	....	X	....
Mr. Marchant	X	....	....	Mr. Davis	....	X	....
Ms. Black	X	....	....	Ms. Sanchez	....	X	....
Mr. Reed	X	....	....	Mr. Higgins	....	X	....
Mr. Kelly	X	....	....	Ms. Sewell	....	X	....
Mr. Renacci	X	....	....	Ms. DelBene	....	X	....
Mr. Meehan	X	....	....	Ms. Chu	....	X	....
Ms. Noem	X	....					
Mr. Holding	X	....	....				
Mr. Smith (MO)	X	....	....				
Mr. Rice	X	....	....				
Mr. Schweikert	X	....	....				
Ms. Walorski	X	....	....				
Mr. Curbelo	X	....	....				
Mr. Bishop	X	....	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 7, 2017.

The vote on the amendment offered by Mr. Blumenauer to the amendment in the nature of a substitute to H.R. 1, which would sunset H.R. 1 in the event the deficit increases, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice							
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 7, 2017.

The vote on the amendment offered by Mr. Pascrell to the amendment in the nature of a substitute to H.R. 1, which would strike the changes to the state and local deduction, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black				Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, “Tax Cuts and Jobs Act,” on November 7, 2017.

The vote on the amendment offered by Mr. Kind to the amendment in the nature of a substitute to H.R. 1, which would repeal the state and local tax deduction for all business organizations, was not agreed to by a roll call vote of 15 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black				Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins			
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, “Tax Cuts and Jobs Act,” on November 7, 2017.

The vote on the amendment offered by Mr. Kind to the amendment in the nature of a substitute to H.R. 1, which would restore the Work Opportunity Tax Credit, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black				Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Rice	....	X	....				
Mr. Schweikert	....	X	....				
Ms. Walorski	....	X	....				
Mr. Curbelo	....	X	....				
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 7, 2017.

The vote on the amendment offered by Ms. Sanchez to the amendment in the nature of a substitute to H.R. 1, which would expand the Child Tax Credit and make permanent the $300 "family flexibility" credit, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....
Mr. Buchanan	....	X	....	Mr. Blumenauer	X	....	....
Mr. Smith (NE)	....	X	....	Mr. Kind	X	....	....
Ms. Jenkins	....	X	....	Mr. Pascrell	X	....	....
Mr. Paulsen	....	X	....	Mr. Crowley	X	....	....
Mr. Marchant	....	X	....	Mr. Davis	X	....	....
Ms. Black	....	....	....	Ms. Sanchez	X	....	....
Mr. Reed	....	X	....	Mr. Higgins	X	....	....
Mr. Kelly	....	X	....	Ms. Sewell	X	....	....
Mr. Renacci	....	X	....	Ms. DelBene	X	....	....
Mr. Meehan	....	X	....	Ms. Chu	X	....	....
Ms. Noem	....	X	....				
Mr. Holding	....	X	....				
Mr. Smith (MO)	....	X	....				
Mr. Rice	....	X	....				
Mr. Schweikert	....	X	....				
Ms. Walorski	....	X	....				
Mr. Curbelo	....	X	....				
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 7, 2017.

The vote on the amendment offered by Mr. Davis to the amendment in the nature of a substitute to H.R. 1, which would reinstate the Adoption Tax Credit, the exclusion for employer-related dependent care, and the exclusion for employer-related adoption assistance and expand the Child and Dependent Care Tax Credit, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black				Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 7, 2017.

The vote on the amendment offered by Mr. Doggett to the amendment in the nature of a substitute to H.R. 1, which would include in gross income the net controlled foreign corporation income of United States shareholders in controlled foreign corporations, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black				Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 7, 2017.

The vote on the amendment offered by Ms. Sewell to the amendment in the nature of a substitute to H.R. 1, which would provide a tax credit to qualified apprenticeship programs, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black				Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Larson to the amendment in the nature of a substitute to H.R. 1, which would strike section 1308 and raise the corporate rate, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Lewis to the amendment in the nature of a substitute to H.R. 1, which would strike section 5201, was not agreed to by a roll call vote of 16 yeas to 23 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....
Mr. Buchanan	....	X	....	Mr. Blumenauer	X	....	....
Mr. Smith (NE)	....	X	....	Mr. Kind	X	....	....
Ms. Jenkins	....	X	....	Mr. Pascrell	X	....	....
Mr. Paulsen	....	X	....	Mr. Crowley	X	....	....
Mr. Marchant	....	X	....	Mr. Davis	X	....	....
Ms. Black	....	X	....	Ms. Sanchez	X	....	....
Mr. Reed	....	X	....	Mr. Higgins	X	....	....
Mr. Kelly	....	X	....	Ms. Sewell	X	....	....
Mr. Renacci	....	....	....	Ms. DelBene	X	....	....
Mr. Meehan	....	X	....	Ms. Chu	X	....	....
Ms. Noem	....	X	....				
Mr. Holding	....	X	....				
Mr. Smith (MO)	....	X	....				
Mr. Rice	....	X	....				
Mr. Schweikert	....	X	....				
Ms. Walorski	....	X	....				
Mr. Curbelo	....	X	....				
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Doggett to the amendment in the nature of a substitute to H.R. 1, which would restore the above-and-line deductions for interest payments on qualified education loans and tuition and related expenses, the exclusions for interest on United States savings bonds used to pay for tuition, qualified tuition reductions, and employer-provided education assistance, and reinstate the above-the-line-deduction for out-of-pocket teacher expenses, and expand the American Opportunity Tax Credit, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....
Mr. Buchanan	....	X	....	Mr. Blumenauer	X	....	....

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (NE)	....	X	....	Mr. Kind	X	....	....
Ms. Jenkins	....	X	....	Mr. Pascrell	X	....	....
Mr. Paulsen	....	X	....	Mr. Crowley	X	....	....
Mr. Marchant	....	X	....	Mr. Davis	X	....	....
Ms. Black	....	X	....	Ms. Sanchez	X	....	....
Mr. Reed	....	X	....	Mr. Higgins	X	....	....
Mr. Kelly	....	X	....	Ms. Sewell	X	....	....
Mr. Renacci	....	X	....	Ms. DelBene	X	....	....
Mr. Meehan	....	X	....	Ms. Chu	X	....	....
Ms. Noem	....	X	....				
Mr. Holding	....	X	....				
Mr. Smith (MO)	....	X	....				
Mr. Rice	....	X	....				
Mr. Schweikert	....	X	....				
Ms. Walorski	....	X	....				
Mr. Curbelo	....	X	....				
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Thompson to the amendment in the nature of a substitute to H.R. 1, which would retroactively extend and make permanent the exclusion from income on mortgage debt forgiveness, and repeal the limitations on the exclusion from capital gain on the sale of a taxpayer's principal residence, with an offset, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....
Mr. Buchanan	....	X	....	Mr. Blumenauer	X	....	....
Mr. Smith (NE)	....	X	....	Mr. Kind	X	....	....
Ms. Jenkins	....	X	....	Mr. Pascrell	X	....	....
Mr. Paulsen	....	X	....	Mr. Crowley	X	....	....
Mr. Marchant	....	X	....	Mr. Davis	X	....	....
Ms. Black	....	X	....	Ms. Sanchez	X	....	....
Mr. Reed	....	X	....	Mr. Higgins	X	....	....
Mr. Kelly	....	X	....	Ms. Sewell	X	....	....
Mr. Renacci	....	X	....	Ms. DelBene	X	....	....
Mr. Meehan	....	X	....	Ms. Chu	X	....	....
Ms. Noem	....	X	....				
Mr. Holding	....	X	....				
Mr. Smith (MO)	....	X	....				
Mr. Rice	....	X	....				
Mr. Schweikert	....	X	....				
Ms. Walorski	....	X	....				
Mr. Curbelo	....	X	....				
Mr. Bishop	....	X	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Ms. Chu to the amendment in the nature of a substitute to H.R. 1, which would expand the Earned Income Tax Credit, and provide for an offset, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, “Tax Cuts and Jobs Act,” on November 8, 2017.

The vote on the amendment offered by Ms. DelBene to the amendment in the nature of a substitute to H.R. 1, which would strike section 3601, and expand low income housing tax credits, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on Mr. Nunes' motion to table Mr. Pascrell's appeal of the ruling of the Chair was agreed to by a roll call vote of 23 yeas to 16 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	X			Mr. Neal		X	
Mr. Johnson	X			Mr. Levin		X	
Mr. Nunes	X			Mr. Lewis		X	
Mr. Tiberi	X			Mr. Doggett		X	
Mr. Reichert	X			Mr. Thompson		X	
Mr. Roskam	X			Mr. Larson		X	
Mr. Buchanan	X			Mr. Blumenauer		X	
Mr. Smith (NE)	X			Mr. Kind		X	
Ms. Jenkins	X			Mr. Pascrell		X	
Mr. Paulsen	X			Mr. Crowley		X	
Mr. Marchant	X			Mr. Davis		X	
Ms. Black	X			Ms. Sanchez		X	
Mr. Reed	X			Mr. Higgins		X	
Mr. Kelly	X			Ms. Sewell		X	
Mr. Renacci	X			Ms. DelBene		X	
Mr. Meehan	X			Ms. Chu		X	
Ms. Noem	X						
Mr. Holding	X						
Mr. Smith (MO)							
Mr. Rice	X						
Mr. Schweikert	X						
Ms. Walorski	X						
Mr. Curbelo	X						
Mr. Bishop	X						

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Ms. Sewell to the amendment in the nature of a substitute to H.R. 1, which would strike section 3602, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Crowley to the amendment in the nature of a substitute to H.R. 1, which would restore the expired credit in section 36, add a new credit for renters purchasing their first home, and provide a credit for taxpayers who rent their homes and for whom their rent exceeds 30 percent of their income, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Pascrell to the amendment in the nature of a substitute to H.R. 1, which would add a new title relating to disaster tax relief, was not agreed to by a roll call vote of 15 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson			
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Ms. DelBene to the amendment in the nature of a substitute to H.R. 1, which would prevent the High Cost Plan Excise Tax from going into effect as scheduled, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on Mr. Reichert's motion to table Mr. Higgins' appeal of the ruling of the Chair was agreed to by a roll call vote of 22 yeas to 16 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	X	....	....	Mr. Neal	....	X	....
Mr. Johnson	X	....	....	Mr. Levin	....	X	....
Mr. Nunes	X	....	....	Mr. Lewis	....	X	....
Mr. Tiberi	X	....	....	Mr. Doggett	....	X	....
Mr. Reichert	X	....	....	Mr. Thompson	....	X	....
Mr. Roskam	X	....	....	Mr. Larson	....	X	....
Mr. Buchanan	....	....	....	Mr. Blumenauer	....	X	....
Mr. Smith (NE)	X	....	....	Mr. Kind	....	X	....
Ms. Jenkins	X	....	....	Mr. Pascrell	....	X	....
Mr. Paulsen	X	....	....	Mr. Crowley	....	X	....
Mr. Marchant	X	....	....	Mr. Davis	....	X	....
Ms. Black	X	....	....	Ms. Sanchez	....	X	....
Mr. Reed	X	....	....	Mr. Higgins	....	X	....
Mr. Kelly	X	....	....	Ms. Sewell	....	X	....
Mr. Renacci	X	....	....	Ms. DelBene	....	X	....
Mr. Meehan	X	....	....	Ms. Chu	....	X	....
Ms. Noem	X	....	....				
Mr. Holding	X	....	....				
Mr. Smith (MO)	X	....	....				
Mr. Rice	....	....	....				
Mr. Schweikert	X	....	....				
Ms. Walorski	X	....	....				
Mr. Curbelo	X	....	....				
Mr. Bishop	X	....	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Doggett to the amendment in the nature of a substitute to H.R. 1, which would strike the repeal of the Alternative Minimum Tax, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	....	X	....	Mr. Neal	X	....	....
Mr. Johnson	....	X	....	Mr. Levin	X	....	....
Mr. Nunes	....	X	....	Mr. Lewis	X	....	....
Mr. Tiberi	....	X	....	Mr. Doggett	X	....	....
Mr. Reichert	....	X	....	Mr. Thompson	X	....	....
Mr. Roskam	....	X	....	Mr. Larson	X	....	....
Mr. Buchanan	....	X	....	Mr. Blumenauer	X	....	....
Mr. Smith (NE)	....	X	....	Mr. Kind	X	....	....
Ms. Jenkins	....	X	....	Mr. Pascrell	X	....	....
Mr. Paulsen	....	X	....	Mr. Crowley	X	....	....
Mr. Marchant	....	X	....	Mr. Davis	X	....	....
Ms. Black	....	X	....	Ms. Sanchez	X	....	....
Mr. Reed	....	X	....	Mr. Higgins	X	....	....
Mr. Kelly	....	X	....	Ms. Sewell	X	....	....
Mr. Renacci	....	X	....	Ms. DelBene	X	....	....
Mr. Meehan	....	X	....	Ms. Chu	X	....	....
Ms. Noem	....	X	....				
Mr. Holding	....	X	....				
Mr. Smith (MO)	....	X	....				
Mr. Rice	....	X	....				

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Levin to the amendment in the nature of a substitute to H.R. 1, which would provide a different method of taxing carried interest compensation as ordinary income, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 8, 2017.

The vote on the amendment offered by Mr. Lewis to the amendment in the nature of a substitute to H.R. 1, which would delay the effective date of all revenue-reducing provisions until the United States withdraws from current wars in Afghanistan, Iraq, and Syria, and the deficit is zero, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 9, 2017.

The vote on the amendment offered by Mr. Blumenauer to the amendment in the nature of a substitute to H.R. 1, which would maintain the wind energy production tax credit as under current law, was not agreed to by a roll call vote of 15 yeas to 22 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes				Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley			
Mr. Marchant				Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 9, 2017.

The vote on the amendment offered by Ms. Chu to the amendment in the nature of a substitute to H.R. 1, which would strike Subtitle G of Title I related to Estate, Gift, and Generation-skipping Transfer Taxes, was not agreed to by a roll call vote of 14 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell			
Mr. Paulsen		X		Mr. Crowley			
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 9, 2017.

The vote on the amendment offered by Mr. Kind to the amendment in the nature of a substitute to H.R. 1, which would create a tax deduction for domestic production in excess of current Section 199, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 9, 2017.

The vote on the amendment offered by Mr. Pascrell to the amendment in the nature of a substitute to H.R. 1, which would require the disclosure to the Ways and Means Committee of the income tax returns of the President, was not agreed to by a roll call vote of 16 yeas to 24 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady		X		Mr. Neal	X		
Mr. Johnson		X		Mr. Levin	X		
Mr. Nunes		X		Mr. Lewis	X		
Mr. Tiberi		X		Mr. Doggett	X		
Mr. Reichert		X		Mr. Thompson	X		
Mr. Roskam		X		Mr. Larson	X		
Mr. Buchanan		X		Mr. Blumenauer	X		
Mr. Smith (NE)		X		Mr. Kind	X		
Ms. Jenkins		X		Mr. Pascrell	X		
Mr. Paulsen		X		Mr. Crowley	X		
Mr. Marchant		X		Mr. Davis	X		
Ms. Black		X		Ms. Sanchez	X		
Mr. Reed		X		Mr. Higgins	X		
Mr. Kelly		X		Ms. Sewell	X		
Mr. Renacci		X		Ms. DelBene	X		
Mr. Meehan		X		Ms. Chu	X		
Ms. Noem		X					
Mr. Holding		X					
Mr. Smith (MO)		X					
Mr. Rice		X					
Mr. Schweikert		X					
Ms. Walorski		X					
Mr. Curbelo		X					
Mr. Bishop		X					

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 9, 2017.

The vote on the amendment offered by Mr. Brady to the amendment in the nature of a substitute to H.R. 1, which would make improvements relating to the maximum rate on business income of individuals, preserve the adoption tax credit, improve the program integrity of the Child Tax Credit, improve the consolidation of education savings rules, preserve the above-the-line deduction for moving expenses of a member of the Armed Forces on active duty, preserve the current law effective tax rates on C corporation dividends subject to the dividends received deduction, improve interest expense rules with respect to accrued interest on floor plan financing indebtedness, modify the treatment of S corporation conversions into C corporations, modify the tax treatment of research and experimentation expenditures, modify the treatment of expenses in contingent fee cases, modify the transition rules on the treatment of deferred foreign income, improve the excise tax on investment income of private colleges and universities, and modify rules with respect to political statements made by certain tax-exempt entities, was agreed to by a roll call vote of 24 yeas to 16 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	X	....	....	Mr. Neal	....	X	....
Mr. Johnson	X	....	....	Mr. Levin	....	X	....
Mr. Nunes	X	....	....	Mr. Lewis	....	X	....
Mr. Tiberi	X	....	....	Mr. Doggett	....	X	....
Mr. Reichert	X	....	....	Mr. Thompson	....	X	....
Mr. Roskam	X	....	....	Mr. Larson	....	X	....
Mr. Buchanan	X	....	....	Mr. Blumenauer	....	X	....
Mr. Smith (NE)	X	....	....	Mr. Kind	....	X	....
Ms. Jenkins	X	....	....	Mr. Pascrell	....	X	....
Mr. Paulsen	X	....	....	Mr. Crowley	....	X	....
Mr. Marchant	X	....	....	Mr. Davis	....	X	....
Ms. Black	X	....	....	Ms. Sanchez	....	X	....
Mr. Reed	X	....	....	Mr. Higgins	....	X	....
Mr. Kelly	X	....	....	Ms. Sewell	....	X	....
Mr. Renacci	X	....	....	Ms. DelBene	....	X	....
Mr. Meehan	X	....	....	Ms. Chu	....	X	....
Ms. Noem	X	....	....				
Mr. Holding	X	....	....				
Mr. Smith (MO)	X	....	....				
Mr. Rice	X	....	....				
Mr. Schweikert	X	....	....				
Ms. Walorski	X	....	....				
Mr. Curbelo	X	....	....				
Mr. Bishop	X	....	....				

In compliance with the Rules of the House of Representatives, the following statement is made concerning the vote of the Committee on Ways and Means during the markup consideration of H.R. 1, "Tax Cuts and Jobs Act," on November 9, 2017.

H.R. 1 was ordered favorably reported to the House of Representatives as amended by a roll call vote of 24 yeas to 16 nays (with a quorum being present). The vote was as follows:

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Brady	X	....	....	Mr. Neal	....	X	....
Mr. Johnson	X	....	....	Mr. Levin	....	X	....
Mr. Nunes	X	....	....	Mr. Lewis	....	X	....
Mr. Tiberi	X	....	....	Mr. Doggett	....	X	....
Mr. Reichert	X	....	....	Mr. Thompson	....	X	....
Mr. Roskam	X	....	....	Mr. Larson	....	X	....
Mr. Buchanan	X	....	....	Mr. Blumenauer	....	X	....
Mr. Smith (NE)	X	....	....	Mr. Kind	....	X	....
Ms. Jenkins	X	....	....	Mr. Pascrell	....	X	....
Mr. Paulsen	X	....	....	Mr. Crowley	....	X	....
Mr. Marchant	X	....	....	Mr. Davis	....	X	....
Ms. Black	X	....	....	Ms. Sanchez	....	X	....
Mr. Reed	X	....	....	Mr. Higgins	....	X	....
Mr. Kelly	X	....	....	Ms. Sewell	....	X	....
Mr. Renacci	X	....	....	Ms. DelBene	....	X	....
Mr. Meehan	X	....	....	Ms. Chu	....	X	....
Ms. Noem	X	....	....				
Mr. Holding	X	....	....				
Mr. Smith (MO)	X	....	....				
Mr. Rice	X	....	....				
Mr. Schweikert	X	....	....				
Ms. Walorski	X	....	....				
Mr. Curbelo	X	....	....				
Mr. Bishop	X	....	....				

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate of Budgetary Effects

In compliance with clause 3(d) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the effects on the budget of the bill, H.R. 1, as reported.

The bill, as reported, is estimated to have the following effect on Federal fiscal year budget receipts for the period 2018–2027:

ESTIMATED BUDGET EFFECTS OF H.R. 1,
THE "TAX CUTS AND JOBS ACT,"
AS REPORTED BY THE COMMITTEE ON WAYS AND MEANS

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
I. Tax Reform for Individuals													
A. Simplification and Reform of Rates, Standard Deduction, and Exemptions													
1. 12%, 25%, 35%, and 39.6% income tax rates with phaseout of 12% income tax bracket for taxpayers with taxable income above $1 million ($1.2 million for joint filers) [1][2]	tyba 12/31/17	-67.6	-96.4	-100.4	-104.2	-108.5	-113.1	-117.3	-122.1	-127.3	-132.4	-477.1	-1,089.4
2. Modify standard deduction to $24,400 for married taxpayers filing jointly; $12,200 for single individuals, and $18,300 for HoH (index for inflation for years beginning after 2019) [2]	tyba 12/31/17	-60.7	-85.2	-86.6	-89.6	-92.5	-94.9	-97.9	-101.3	-104.9	-107.9	-414.5	-921.4
3. Repeal of deduction for personal exemptions [2]	tyba 12/31/17	96.2	141.4	145.8	150.8	156.4	162.2	168.1	174.1	180.3	186.7	690.6	1,562.1
4. Alternative inflation measure [2]	tyba 12/31/17	0.7	2.1	5.5	8.2	10.6	12.9	16.8	20.2	23.3	27.8	27.2	128.2
5. 25% pass-through tax rate with lower rate for small passthrough entities [3]	tyba 12/31/17	-30.4	-51.6	-56.1	-58.8	-61.4	-61.1	-62.5	-67.1	-71.5	-76.0	-258.4	-596.6
B. Simplification and Reform of Family and Individual Tax Credits													
1. New personal credits and modification of child tax credit:													
a. $1,600 child credit not indexed; refundable up to $1,000 indexed up to nearest $100 base year 2017; $300 non-refundable personal credit for all other individuals receiving present-law personal and dependent exemptions (not indexed, sunsets 12/31/22) [2]	tyba 12/31/17	-30.4	-63.3	-63.3	-63.0	-62.5	-43.7	-26.2	-25.9	-25.8	-26.6	-282.5	-430.7
b. Increase in phaseout threshold of child credit and application of phaseout to personal credits ($115,000/$230,000, indexed) [2]	tyba 12/31/17	-14.0	-22.6	-24.3	-26.1	-27.9	-20.5	-16.9	-17.9	-19.0	-20.1	-114.9	-209.3
2. Repeal of nonrefundable personal credits:													
a. Repeal of elderly and disabled credit	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
b. Repeal of credit for new qualified plug-in electric vehicles	vaa 12/31/17	[4]	0.1	[4]	[4]	[5]	[5]	[5]	[5]	[5]	[5]	0.2	0.2
c. Termination of credit for interest on certain home mortgages	tyea 12/31/17	*Estimate Included in Item II.H.1.*											
3. Refundable credit program integrity:													
a. Require valid Social Security number of at least one taxpayer to claim refundable portion of child credit [2]	tyba 12/31/17	---	2.8	2.7	2.6	2.5	2.5	2.2	2.1	2.1	2.1	10.6	21.7
b. Denial of both refundable and non-refundable child tax credit for failure of the child to have an SSN (child still receives $300 nonrefundable credit) [2]	tyba 12/31/17	0.4	1.6	1.6	1.6	1.6	2.3	2.8	2.8	2.9	3.0	6.6	20.4
c. Require valid Social Security number for student for purposes of the AOTC [2]	tyba 12/31/17	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
d. Individuals prohibited from engaging in employment in United States not eligible for EITC [2]	tyba 12/31/17	[4]	0.1	0.1	0.1	0.1	0.1	0.1	[4]	[4]	[4]	0.4	0.6
4. Procedures to reduce improper claims of earned income credit	tyea DOE	*Negligible Revenue Effect*											
5. Certain income disallowed for purposes of the EITC	tyea DOE	*No Revenue Effect*											
C. Simplification of Education Incentives													
1. American opportunity tax credit [2][6]	tyba 12/31/17	0.3	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.1	2.1	7.3	17.3
2. Consolidation of education savings rules and allow rollovers from 529 accounts to ABLE accounts	tyba 12/31/17	[5]	[5]	[5]	[5]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
3. Reforms to discharge of certain student loan indebtedness	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	-0.1
4. Repeal of other provisions relating to education [2][7]	tyba & apoia 12/31/17	0.8	4.6	4.8	4.9	5.0	5.2	5.3	5.5	5.6	5.8	20.1	47.5
5. Rollovers between qualified tuition programs and qualified ABLE programs	da 12/31/17	*Estimate Included in Item I.C.5.*											
D. Simplification and Reform of Deductions													
1. Repeal of itemized deductions except mortgage interest, investment interest, charitable contributions, up to $10,000 in real property taxes, and certain miscellaneous expenses [2][8][9]	tyba 12/31/17	56.9	102.8	107.8	115.6	123.6	132.1	141.1	150.5	160.3	170.6	506.6	1,261.3
2. Repeal of overall limitation on itemized deductions	tyba 12/31/17	*Estimate Included in Item I.D.1.*											
3. Repeal of deduction for taxes not paid or accrued in a trade or business	tyba 12/31/17	*Estimate Included in Item I.D.1.*											
4. Repeal of deduction for personal casualty and theft losses (except in the case of casualty losses sustained as a result of hurricanes Harvey/Irma/Maria)	tyba 12/31/17 & lao/a 8/23/17, 9/4/17, or 9/16/17	*Estimate Included in Item I.D.1.*											
5. Limitation on wagering losses	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.1
6. Repeal of deduction for tax preparation expenses	tyba 12/31/17	*Estimate Included in Item I.D.1.*											
7. Repeal the deduction for medical expenses	tyba 12/31/17	*Estimate Included in Item I.D.1.*											

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
8. Repeal of deduction for alimony payments and corresponding inclusion in gross income	dosaeia 12/31/17	0.1	0.2	0.4	0.5	0.7	0.9	1.0	1.3	1.5	1.8	1.8	8.3
9. Repeal of deduction for moving expenses (other than members of the Armed Forces)	tyba 12/31/17	0.6	0.8	0.9	0.9	1.0	1.0	1.1	1.1	1.2	1.2	4.2	9.8
10. Termination of deduction and exclusions for contributions to medical savings accounts	tyba 12/31/17	*Negligible Revenue Effect*											
11. Denial of deduction for expenses attributable to the trade or business of being an employee	tyba 12/31/17	*Estimate Included in Item I.D.1.*											
12. Denial of deduction for educator expenses	tyba 12/31/17	[4]	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.9	2.1
E. Simplification and Reform of Exclusions and Taxable Compensation													
1. Limitation on exclusion for employer-provided housing [10]	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
2. Modify exclusion of gain from sale of a principal residence	saea 12/31/17	0.2	1.7	2.1	2.2	2.3	2.5	2.6	2.8	3.0	3.1	8.4	22.4
3. Repeal of exclusion for employee achievement awards, etc. [11]	tyba 12/31/17	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	1.7	3.8
4. Exclusion for dependent care assistance programs (sunset 12/31/22) [12]	tyba 12/31/17	---	---	---	---	---	0.5	0.7	0.7	0.7	0.7	---	3.4
5. Repeal of exclusion for qualified moving expense reimbursement [13]	tyba 12/31/17	0.4	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	2.8	6.2
6. Repeal of exclusion for adoption assistance programs	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
F. Simplification and Reform of Savings, Pensions, Retirement													
1. Repeal of special rule permitting recharacterization of IRA contributions	tyba 12/31/17	[4]	[4]	[4]	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
2. Reduction in minimum age for allowable in-service distributions	pyba 12/31/17	1.0	1.3	1.3	1.3	1.3	1.3	1.4	1.4	1.4	1.4	6.2	13.1
3. Modification of rules governing hardship distributions	pyba 12/31/17	*Negligible Revenue Effect*											
4. Modification of rules relating to hardship withdrawals from cash or deferred arrangements	pyba 12/31/17	0.1	0.1	0.2	0.2	0.1	0.1	0.1	[4]	-0.1	-0.1	0.7	0.7
5. Extended rollover period for certain plan loan offsets	tyba 12/31/17	*Negligible Revenue Effect*											
6. Modification of nondiscrimination rules for certain employer-sponsored plans	generally DOE	*Negligible Revenue Effect*											
G. Double Estate, Gift, and GST Tax Exemption Amount; After 2024 Repeal Estate and GST Taxes and Reduce Gift Tax Rate to 35%	dda & gma 12/31/17	-1.3	-8.5	-9.3	-9.6	-10.1	-11.2	-13.0	-15.0	-34.6	-38.0	-38.8	-150.7
H. Repeal of Alternative Minimum Tax on Individuals	tyba 12/31/17	-6.0	-72.8	-64.1	-67.6	-71.3	-74.7	-78.5	-82.7	-86.7	-90.9	-281.9	-695.5
Total of Tax Reform for Individuals		**-52.5**	**-137.9**	**-127.9**	**-126.9**	**-125.8**	**-92.4**	**-65.7**	**-66.1**	**-84.0**	**-84.2**	**-571.2**	**-963.7**

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
II. Business Tax Reform													
A. Repeal of Alternative Minimum Tax on Corporations [2]...	tyba 12/31/17	-6.8	-6.9	-6.6	-6.8	-7	-1.3	-1.3	-1.3	-1.2	-1.1	-34.0	-40.3
B. Reduction in Corporate Tax Rate to 20%...	tyba 12/31/17	-107.8	-135.2	-141.8	-142.3	-143.2	-147	-151.5	-155.7	-161.9	-169.7	-670.3	-1,456.0
C. Cost Recovery - Provide Section 168(k) Expensing for Qualified Investments (sunset 12/31/22) [14]...	paa 9/27/17 apisasd & sppoga 9/27/17	-24.8	-22.9	-16	-11.3	-9.2	8.2	20.7	14.4	10.0	6.0	-84.3	-25.0
D. Small Business Reforms													
1. Increase Section 179 expensing to $5 million with a phaseout beginning at $20 million (sunset 12/31/22) and expand to include qualified energy efficient heating and air-conditioning property...	[15]	-7.0	-13.5	-11.4	-9.5	-8.6	5.2	15.4	9.7	5.7	2.6	-50.0	-11.4
2. Small business accounting method reform and simplification...	[16]	-7.5	-7.4	-3.3	-2.0	-1.6	-1.5	-1.6	-1.6	-1.7	-1.8	-21.8	-30.0
3. Small business exception from limitation on deduction of business interest...	tyba 12/31/17	*Estimate Included in Item II.E.1.*											
4. Modify treatment of S corporation conversions into C corporations...	DOE	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-2.8	-6.1
E. Reform of Business Related Exclusions, Deductions, etc.													
1. Limit net interest deductions to 30% of adjusted taxable income, carryforward of denied deduction...	tyba 12/31/17	8.0	17.0	18.9	18.8	17.8	17.6	17.3	17.7	18.8	19.8	80.4	171.7
2. Modification of net operating loss deduction...	tyba 12/31/17	6.2	9.7	11.2	15.4	23.7	30.6	28.7	19.3	9.1	2.4	66.1	156.0
3. Repeal like-kind exchanges except for real property...	generally eca 12/31/17	0.6	1.0	1.3	1.8	2.3	2.9	3.7	4.5	5.6	6.7	7.0	30.5
4. Revision of treatment of contributions to capital...	cmateia DOE	1.0	1.1	1.0	0.9	0.8	0.7	0.6	0.5	0.5	0.4	4.8	7.4
5. Repeal of deduction for local lobbying expenses...	apoia 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.4	0.8
6. Repeal of deduction for income attributable to domestic production activities...	tyba 12/31/17	4.2	8.8	9.3	9.6	9.8	9.9	10.3	10.7	11.2	11.6	41.6	95.2
7. Entertainment, etc., expenses:													
a. Entertainment [17]...	apoia 12/31/17	1.5	2.0	2.0	2.0	2.1	2.1	2.2	2.2	2.4	2.5	9.6	21.0
b. Repeal of deduction for employer-provided qualified transportation and parking...	apoia 12/31/17	0.7	0.9	1.0	1.0	1.1	1.1	1.1	1.2	1.3	1.3	4.7	10.8
c. Repeal of deduction for employer-provided gyms...	apoia 12/31/17	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	2.0
8. UBTI increased by amount of certain fringe benefit expenses for which deduction is disallowed...	apoia 12/31/17	*Estimate Included in Items II.E.7.b.-c.*											
9. Limitation on deduction for FDIC premiums...	tyba 12/31/17	0.5	1.4	1.4	1.4	1.4	1.5	1.5	1.5	1.6	1.6	6.1	13.7
10. Repeal of rollover of publicly traded securities gain into specialized small business investment companies...	sa 12/31/17	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	1.1	1.7
11. Certain self-created property not treated as a capital asset...	Da 12/31/17	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
12. Repeal of special rule for sale or exchange of patents...	Da 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.3
13. Repeal of technical termination of partnerships...	ptyba 12/31/17	0.1	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.7	1.7

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
14. Recharacterization of certain gains on property held for fewer than 3 years in the case of partnership profits interest held in connection with performance of investment services	tyba 12/31/17	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7	1.2
15. Amortization of research and experimental expenditures	apoii tyba 12/31/22	---	---	---	---	---	23.2	31.5	24.9	18.1	10.9	---	108.6
16. Uniform treatment of expenses in contingency fee cases	eacpoii tyba DOE	[4]	0.1	0.1	0.1	0.1	[4]	[4]	[4]	[4]	[4]	0.4	0.5
F. Reform of Business Credits													
1. Repeal of credit for clinical testing expenses for certain drugs for rare diseases or conditions	apoii tyba 12/31/17	1.2	2.8	3.4	4.1	4.9	5.8	6.7	7.5	8.4	9.2	16.4	54.0
2. Repeal of employer-provided child care credit	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.2
3. Repeal of rehabilitation credit	[18]	[4]	0.4	0.8	1.0	1.1	1.1	1.2	1.2	1.3	1.4	3.2	9.3
4. Repeal of work opportunity tax credit	apoitiwbwftea 12/31/17	0.4	1.1	0.9	0.4	0.4	0.3	0.1	0.1	---	---	3.2	3.6
5. Repeal of deduction for certain unused business credits	tyba 12/31/17	Negligible Revenue Effect											
6. Termination of new markets tax credit	cyba 12/31/17	---	[4]	[4]	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	1.7
7. Repeal of credit for expenditures to provide access to disabled individuals	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.3
8. Modification of credit for portion of employer Social Security taxes paid with respect to employee tips [19]	tyba 12/31/17	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	1.9	3.9
G. Energy Credits													
1. Modifications to credit for electricity produced from certain renewable resources	tyea DOE	---	---	0.8	1.6	1.7	1.9	1.9	1.8	1.6	1	4.1	12.3
2. Modification of the section 48 energy investment tax credit	pa 12/31/16 & DOE	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1	[5]	[5]	[5]	[4]	-1.0	-1.2
3. Extension and phaseout of residential energy efficient property	ppisa 12/31/16	-0.1	-0.3	-0.3	-0.3	-0.2	[5]	[5]	---	---	---	-1.1	-1.1
4. Repeal of enhanced oil recovery credit	tyba 12/31/17	0.1	[4]	[4]	[4]	[4]	[4]	---	---	---	---	0.2	0.2
5. Repeal of credit for producing oil and gas from marginal wells	tyba 12/31/17	No Revenue Effect											
6. Modifications of credit for production from advanced nuclear power facilities	DOE & tyba DOE	[5]	[5]	[5]	[5]	[5]	[5]	-0.1	-0.1	-0.2	-0.2	[5]	-0.4
H. Bond Reforms													
1. Termination of private activity bonds	bia 12/31/17	0.4	1.1	1.8	2.5	3.4	4.2	5.1	5.9	6.8	7.7	9.2	38.9
2. Repeal of advance refunding bonds	ar bia 12/31/17	0.3	1	1.4	1.8	2	2.1	2.1	2.2	2.2	2.2	6.5	17.3
3. Repeal of tax credit bonds [2]	bia 12/31/17	[4]	[4]	[4]	[4]	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.5
4. No tax exempt bonds for professional stadiums	bia 11/2/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.2
I. Insurance													
1. Net operating losses of life insurance companies	lai tyba 12/31/17	Estimate Included in Item II.D.1											
2. Repeal of small life insurance company deduction	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.1	0.2
3. Impose 8% surtax on life insurance company income	tyba 12/31/17	1.5	2.1	2.2	2.3	2.3	2.4	2.4	2.5	2.6	2.7	10.4	23.0

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
4. Adjustment for change in computing reserves	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
5. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
6. Modification of proration rules for property and casualty insurance companies	tyba 12/31/17	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	2.1
7. Modification of discounting rules for property and casualty insurance companies	tyba 12/31/17	0.3	1.8	1.8	1.8	1.8	1.8	1.8	1.4	0.5	0.2	7.5	13.2
8. Repeal of special estimated tax payments	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
J. Compensation													
1. Modification of limitation on excessive employee remuneration	tyba 12/31/17	0.1	1.1	1.1	1.1	1.1	1.0	1.0	1.0	0.9	0.8	4.5	9.3
2. 20% excise tax on excess tax-exempt organization executive compensation	tyba 12/31/17	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	1.7	3.6
3. Treatment of qualified equity grants	[20]	-0.2	-0.3	-0.2	-0.2	-0.1	-0.1	[5]	[5]	-0.1	-0.1	-1.0	-1.2
Total of Business Tax Reform		**-126.5**	**-131.6**	**-118.0**	**-103.5**	**-90.8**	**-24.7**	**2.5**	**-26.9**	**-54.9**	**-80.3**	**-570.5**	**-754.2**
III. Taxation of Foreign Income and Foreign Persons													
A. Establishment of Participation Exemption System for Taxation of Foreign Income													
1. Deduction for foreign-source portion of dividends received by domestic corporations from specified 10-percent owned foreign corporations	[21]	-14.5	-24.4	-19.2	-19.5	-19.8	-19.6	-20.9	-22	-22.2	-23.1	-97.4	-205.1
2. Application of participation exemption to investment in United States property	[22]	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0	-2.0
3. Limitation on losses with respect to specified 10-percent owned foreign corporations	dma 12/31/17	0.1	0.2	0.5	0.8	1.1	1.4	1.6	1.5	1.7	2.2	2.8	11.1
4. Treatment of deferred foreign income upon transition to participation exemption system of taxation and deemed repatriation at two-tier rate (14-percent rate for liquid assets, 7-percent rate for illiquid assets)	[23]	79.2	53.6	26.7	26.0	26.4	26.6	26.9	27.2	9.0	-8.2	212.0	293.4
B. Modifications Related to Foreign Tax Credit System													
1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis	tyba 12/31/17	*Estimate Included in Item III.A.4.*											
2. Source of income from sales of inventory determined solely on basis of production activities	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.5
C. Modification of Subpart F Provisions													
1. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment	[22]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
2. Repeal of foreign base company oil related income as subpart F income	[22]	-0.1	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.6	-1.4	-3.9

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
3. Inflation adjustment of de minimis exception for foreign base company income	[22]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	-0.2	-0.4
4. Look-thru rule for related controlled foreign corporations made permanent	[24]	---	---	-0.8	-1.2	-1.3	-1.4	-1.5	-1.7	-1.8	-2.0	-3.3	-11.8
5. Modification of stock attribution rules for determining status as a controlled foreign corporation	[22]	Estimate Included in Item III.A.1.											
6. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply	[22]	[4]	0.1	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	0.2	0.4
D. Prevention of Base Erosion													
1. Current year inclusion by United States shareholders with foreign high returns	[22]	4.4	7.9	6.9	6.8	6.7	6.6	6.8	7.1	7.3	7.0	32.7	67.5
2. Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group	tyba 12/31/17	1.6	3.1	3.0	3.1	3.2	3.6	3.9	4.1	4.2	4.3	14.1	34.2
3. Excise tax on outbound related-party payments; ECI election	apoaa 12/31/18	---	2.0	7.6	11.5	11.7	11.8	11.9	12.3	12.6	13.1	32.8	94.5
E. Provisions Related to the Possessions of the United States													
1. Extension of deduction allowable with respect to income attributable to domestic production activities in Puerto Rico (sunset 12/31/17)	tyba 12/31/16	-0.1	---	---	---	---	---	---	---	---	---	-0.1	-0.1
2. Extension of temporary increase in limit on cover over of rum excise taxes (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/22) [2][25]	dsbitUSa 12/31/16	-0.3	-0.1	-0.1	-0.1	-0.1	[5]	---	---	---	---	-0.8	-0.9
3. Extension of American Samoa economic development credit (sunset 12/31/22)	tyba 12/31/16	[5]	[5]	[5]	[5]	[5]	[5]	---	---	---	---	-0.1	-0.1
F. Other International Reforms													
1. Restriction on insurance business exception to passive foreign investment company rules	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.1
Total of Taxation of Foreign Income and Foreign Persons		**70.4**	**42.1**	**24.3**	**27.1**	**27.5**	**28.6**	**28.3**	**28.1**	**10.4**	**-7.2**	**191.1**	**278.4**
IV. Exempt Organizations													
A. Unrelated Business Income Tax													
1. Clarification of unrelated business income tax treatment of State and local retirement plans	tyba 12/31/17	0.1	0.3	0.2	0.1	0.1	0.1	0.1	[4]	[4]	[4]	0.9	1.1
2. Exclusion of research income limited to publicly available research	tyba 12/31/17	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.7
B. Excise Taxes													
1. Simplification of excise tax on private foundation investment income	tyba 12/31/17	[4]	[4]	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
2. Require art museum to provide public access to qualify as a private operating foundation	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
3. Excise tax based on investment income of private colleges and universities	tyba 12/31/17	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	1.2	2.5
4. Exception to private foundation excess business holdings rules for philanthropic business holdings	tyba 12/31/17	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
C. Requirements for Organizations Exempt From Tax													
1. Modifications to prohibition on political campaign activity for tax-exempt organizations	tyea DOE	---	-0.2	-0.5	-0.4	-0.4	-0.4	-0.1	---	---	---	-1.5	-2.1
2. Modified reporting requirements for donor advised funds sponsoring organizations	rff tyba 12/31/17	*No Revenue Effect*											
Total of Exempt Organizations		**0.3**	**0.4**	**[4]**	**0.1**	**0.2**	**0.2**	**0.5**	**0.5**	**0.5**	**0.5**	**1.1**	**2.7**
NET TOTAL		**-108.4**	**-227.0**	**-221.7**	**-203.3**	**-188.9**	**-88.3**	**-34.4**	**-64.4**	**-128.0**	**-171.1**	**-949.6**	**-1,436.8**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is generally assumed to be December 1, 2017.

Legend for "Effective" column:

apisasd = and placed in service after such date
apoaa = amounts paid or accrued after
apoia = amounts paid or incurred after
apoii = amounts paid or incurred in
apoitiwbwftea = amounts paid or incurred to individuals who begin work for the employer after
ar = advance refunding
bia = bonds issued after
cmateia = contributions made and transactions entered into after
cyba = calendar years beginning after
da = distributions after
Da = dispositions after
dda = decedents dying after
DOE = date of enactment
dosaeia = divorce or separation agreement entered into after
dsbitUSa = distilled spirits brought into the United States after
eacpoii = expenses and costs paid or incurred in
eca = exchanges completed after
gma = gifts made after
lai = losses arising in
lao/a = losses arising on or after
pa = periods after
paa = property acquired after
pyba = plan years beginning after
ptyba = partnership taxable years beginning after
rff = returns filed for
sa = sales after
saea = sales and exchanges after
sppoga = specified plants planted or grafted after
tyba = taxable years beginning after
tyea = taxable years ending after
vaa = vehicles acquired after

[Footnotes for the Table appear on the following pages]

Footnotes for the Table:

[1] The parameters for the beginning of the 35% and 39.6% rate bracket and the phaseout of the 12-percent bracket use 2018 as the base year. The standard deduction amount uses 2019 as the base year. Other indexed parameters are adjusted for inflation from their 2017 values using the chained CPI-U as the inflation measure to determine 2018 values.

[2] Estimate includes the following outlay effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
12%, 25%, 35%, and 39.6% income tax rates	---	-1.6	-1.6	-1.6	-1.6	-1.6	-1.7	-1.7	-1.7	-1.7	-6.3	-14.7
Modify standard deduction	---	10.6	10.7	11.1	11.3	11.5	11.6	11.7	11.9	12.1	43.8	102.6
Repeal of deduction for personal exemptions	-11.7	-17.3	-17.8	-18.0	-18.4	-18.7	-18.9	-19.2	-19.4	-19.6	-83.2	-179.2
Alternative inflation measure	---	-0.3	-0.6	-1.3	-1.6	-2.1	-2.5	-3.1	-3.6	-4.0	-3.9	-19.2
New personal credits and modification of child credit	---	16.8	17.1	17.1	17.0	18.5	12.0	11.9	11.9	12.9	68.0	135.3
Increase in phaseout threshold of child credit and application of phaseout to personal credits	---	[26]	[26]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.7
Require valid Social Security number of at least one taxpayer to claim refundable portion of child credit	---	-2.8	-2.7	-2.6	-2.5	-2.5	-2.2	-2.1	-2.1	-2.1	-10.6	-21.7
Denial of both refundable and non-refundable child tax credit for failure of the child to have an SSN (child still receives $300 nonrefundable credit)	---	-1.0	-1.0	-0.9	-0.9	-0.9	-1.0	-1.0	-1.0	-1.0	-3.8	-8.9
Require valid Social Security number for student for purposes of the AOTC	---	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
Individuals prohibited from engaging in employment in United States not eligible for EITC	[27]	-0.1	-0.1	-0.1	-0.1	[27]	[27]	[27]	[27]	[27]	-0.3	-0.5
American opportunity tax credit	---	[26]	[26]	[26]	[26]	[26]	[26]	[27]	[27]	[27]	0.2	0.2
Repeal of other provisions relating to education	---	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.9	-2.4
Repeal of itemized deductions except mortgage interest, investment interest, charitable contributions, up to $10,000 in real property taxes, and certain miscellaneous expenses	---	-0.4	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-1.5	-3.8
Repeal of alternative minimum tax on corporations	2.2	2.3	1.7	1.9	1.9	---	---	---	---	---	10.2	10.2
Repeal of tax credit bonds	[27]	[27]	[27]	[27]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Extension of temporary increase in limit on cover over of rum excise taxes (from $10.50 to $13.25 per proof gallon) to Puerto Rico and the Virgin Islands (sunset 12/31/22) [25]	0.3	0.1	0.1	0.1	0.1	[26]	---	---	---	---	0.8	0.9

[3] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	-1.8	-2.7	-2.5	-2.1	-1.6	2.1	3.6	2.4	1.7	1.2	-10.8	0.1
On-budget effects	-0.4	-0.6	-0.5	-0.4	-0.3	0.4	0.8	0.5	0.3	0.2	-2.2	[6]
Off-budget effects	-1.5	-2.1	-1.9	-1.7	-1.3	1.7	2.8	1.9	1.3	0.9	-8.6	0.1

[4] Gain of less than $50 million.

[5] Loss of less than $50 million.

[6] Estimate includes repeal of Lifetime Learning Credit, Hope Credit, and tuition deduction.

[Footnotes for the Table continue on the following pages]

Footnotes for the Table continued:

[7] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	0.8	4.6	4.8	4.9	5.0	5.2	5.3	5.5	5.6	5.8	20.1	47.5
On-budget effects	0.6	3.6	3.8	3.8	4.0	4.1	4.2	4.4	4.4	4.6	15.8	37.5
Off-budget effects	0.1	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.2	1.2	4.3	9.9

[8] Estimate includes $-2.8 billion in net revenue loss from the from the following modifications to the charitable deduction rules: (1) increasing the percentage limit for cash contributions to public charities; (2) allowing the charitable standard mileage rate to be adjusted for inflation; (3) denying a deduction for payments for stadium seating rights; and (4) repealing existing authority for an alternative substantiation procedure under section 170(f)(8)(D).

[9] Mortgage interest deduction is modified by lowering the limit on acquisition indebtedness to $500,000 for a principal residence acquired after the date of enactment and repealing the deductibility of interest on second homes and home equity loans.

[10] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
On-budget effects	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]
Off-budget effects	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]	[4]

[11] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	0.2	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5	1.7	3.8
On-budget effects	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	1.1	2.4
Off-budget effects	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.6	1.4

[12] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	---	---	---	---	---	0.5	0.7	0.7	0.7	0.7	---	3.4
On-budget effects	---	---	---	---	---	0.1	0.3	0.3	0.3	0.3	---	1.2
Off-budget effects	---	---	---	---	---	0.4	0.4	0.4	0.4	0.4	---	2.2

[13] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	0.4	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7	2.8	6.2
On-budget effects	0.3	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6	2.2	4.9
Off-budget effects	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.6	1.3

[14] Estimate includes interaction with the increased and expanded section 179 expensing in II.D.1.

[15] The increases in the thresholds are effective for taxable years beginning after December 31, 2017, and before January 1, 2023, and the thresholds are indexed for inflation for taxable years beginning after December 31, 2018. The expansion to include qualified energy efficient heating and air-conditioning property is effective for property acquired and placed in service after November 2, 2017.

[16] The increase in the threshold, and the creation or expansion of a small business threshold where applicable, is effective for taxable years beginning after December 31, 2017, and the threshold is indexed for inflation for taxable years beginning after December 31, 2018. The increase in the section 460(e)(1)(B) threshold is effective for contracts entered into after December 31, 2017, in taxable years ending after such date.

[17] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	1.5	2.0	2.0	2.0	2.1	2.1	2.2	2.2	2.4	2.5	9.6	21.0
On-budget effects	1.2	1.6	1.6	1.7	1.7	1.7	1.8	1.8	2.0	2.1	7.8	17.1
Off-budget effects	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	1.8	3.9

[Footnotes for the Table continue on the following page]

Footnotes for the Table continued:

[18] Generally effective for amounts paid or incurred after December 31, 2017, with a transition rule providing that for buildings owned or leased at all times after December 31, 2017, the 24-month period for making qualified rehabilitation expenditures begins no later than 180 days after the date of enactment, and the repeal is effective for such expenditures paid or incurred after the end of the taxable year in which such 24-month period ends.

[19] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	1.9	3.9
On-budget effects	0.2	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.3	0.3	1.6	3.4
Off-budget effects	[4]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5

[20] Effective for options exercised or restricted stock units settled after December 31, 2017. The penalty for failure to provide a notice is effective for failures after December 31, 2017.

[21] The amendments made by this section shall apply to distributions made after (and, in the case of the amendments made by subsection (d), deductions with respect to taxable years ending after) December 31, 2017.

[22] Effective for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

[23] Effective for the last taxable year of foreign corporations beginning before January 1, 2018, and to taxable years of the United States shareholders in which or with which such taxable years of foreign corporations end.

[24] Effective for taxable years of foreign corporations beginning after December 31, 2019, and to taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

[25] Estimate provided by the Congressional Budget Office.

[26] Increase in outlays of less than $50 million.

[27] Decrease in outlays of less than $50 million.

Clause 8 of rule XIII of the Rules of the House of Representatives requires that an estimate provided by the Joint Committee on Taxation to the Director of the Congressional Budget Office under section 201(f) of the Congressional Budget Act of 1974 for any major legislation shall, to the extent practicable, incorporate the budgetary effects of changes in economic output, employment, capital stock, and other macroeconomic variables resulting from such legislation. Major legislation is defined as legislation having a gross budgetary effect (before incorporating macroeconomic effects) that is greater in any fiscal year than 0.25 percent of the current projected gross domestic product of the United States for that fiscal year. The bill meets this definition of major legislation.

The staff of the Joint Committee on Taxation is currently analyzing changes in economic output, employment, capital stock, and other macroeconomic variables resulting from the bill for purposes of determining these budgetary effects. However, it was not practicable to complete this analysis, which requires accounting for the effects of each provision in this bill, along with interactions between these provisions, by the filing of this report.

B. Statement Regarding New Budget Authority and Tax Expenditures Budget Authority

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee states that the bill involves no new or increased budget authority. The Committee further states that the revenue-reducing provisions of the bill include increased tax expenditures.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, requiring a cost estimate prepared by the CBO, the following statement by CBO is provided.

U.S. Congress,
Congressional Budget Office,
Washington, DC, November 13, 2017.

Hon. Kevin Brady,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 1, a bill to provide for reconciliation pursuant to titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018. It contains the revenue estimates prepared by the staff of the Joint Committee on Taxation.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Cecilia Pastrone.

Sincerely,

Keith Hall,
Director.

Enclosure.

H.R. 1—A bill to provide for reconciliation pursuant to titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018

Summary: H.R. 1, the Tax Cuts and Jobs Act, would amend numerous provisions of U.S. tax law. The bill would modify the individual income tax brackets and tax rates in effect under current law. The bill also would increase the standard deduction and the child tax credit. Deductions for personal exemptions and certain itemized deductions would be repealed, along with the individual and corporate alternative minimum tax (AMT) and, starting in 2025, the estate tax. H.R. 1 would replace the structure of corporate income tax rates, which has a top rate of 35 percent under current law, with a single 20 percent rate, and would establish a maximum tax rate of 25 percent for qualified business income of an individual from certain pass-through entities. Among other changes, the bill would also substantially alter the current system under which U.S. corporations are subject to taxation on their worldwide income.

The staff of the Joint Committee on Taxation (JCT) estimates that enacting the bill would reduce revenues by about $1,438 billion over the 2018–2027 period, and decrease outlays by $2 billion over the same period, leading to an increase in the deficit of $1,437 billion over the next 10 years. A portion of the changes in revenues would be from Social Security payroll taxes, which are off-budget. Excluding the estimated $19 billion increase in off-budget revenues over the next 10 years, JCT estimates that H.R. 1 would increase on-budget deficits by about $1,456 billion over the period from 2018 to 2027. Pay-as-you-go procedures apply because enacting the legislation would affect direct spending and revenues.

JCT estimates that enacting the legislation would not increase net direct spending by more than $2.5 billion in any of the four consecutive 10-year periods beginning in 2028.

Because of the magnitude of the estimated budgetary effects, this bill is considered to be "major legislation," as defined in section 5107 of H. Con. Res. 71, the Concurrent Resolution on the Budget for Fiscal Year 2018. Hence, it triggers the requirement that the cost estimate, to the extent practicable, include the budgetary impact of its macroeconomic effects. The staff of the Joint Committee on Taxation is currently analyzing changes in economic output, employment, capital stock, and other macroeconomic variables resulting from the bill for purposes of determining these budgetary effects. However, JCT indicates it is not practicable for a macroeconomic analysis to incorporate the full effects of all of the provisions in the bill, including interactions between these provisions, within the very short time available between completion of the bill and the filing of the committee report.

JCT has determined that the tax provisions of the bill contain no intergovernmental or private sector mandates as defined in the Unfunded Mandates Reform Act (UMRA).

Estimated cost to the Federal Government: The estimated budgetary effect of H.R. 1 is shown in the following table.

BASIS OF ESTIMATE

Revenues and direct spending

The Congressional Budget Act of 1974, as amended, stipulates that revenue estimates provided by the staff of the Joint Committee on Taxation will be the official estimates for all tax legislation considered by the Congress. As such, CBO incorporates those estimates into its cost estimates of the effects of legislation. Virtually all of the estimates for the provisions of H.R. 1 were provided by JCT. The date of enactment is generally assumed to be December 1, 2017.

JCT estimates that, together, the provisions contained in H.R. 1 would decrease federal revenues on net by about $118 billion in 2018, by $937 billion over the period from 2018 to 2022, and by $1,438 billion over the period from 2018 to 2027. Net outlays would decrease by $9 billion in 2018, increase by $13 billion from 2018 to 2022, and decrease by $2 billion over the period from 2018 to 2027. On net, deficits would increase by $108 billion in 2018, by $950 billion from 2018 to 2022, and by $1,437 billion from 2018 to 2027. A portion of those effects reflect changes to revenues from Social Security taxes, which are off-budget. Over the 2018 to 2027 period, the bill would increase on-budget deficits by $1,456 billion and reduce off-budget deficits by $19 billion, as estimated by JCT.

	By fiscal year, in billions of dollars—											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018–2022	2018–2027
CHANGES IN REVENUES												
Tax Reform for Individuals	−64.2	−134.3	−124.5	−123.8	−123.3	−88.9	−69.1	−70.4	−88.8	−88.4	−569.6	−975.9
Business Tax Reform	−124.3	−129.3	−116.3	−101.6	−89.0	−24.8	2.4	−27.0	−55.0	−80.4	−560.4	−744.5
Taxation of Foreign Income and Foreign Persons	70.7	42.2	24.4	27.2	27.6	28.6	28.3	28.1	10.4	−7.2	191.9	279.3
Exempt Organizations	0.3	0.4	*	0.1	0.2	0.2	0.5	0.5	0.5	0.5	1.1	2.7
Total Estimated Changes in Revenues	−117.6	−221.0	−216.5	−198.2	−184.5	−84.9	−37.9	−68.8	−132.9	−175.4	−937.1	−1,438.4
On-Budget	−116.7	−220.6	−216.3	−198.2	−185.0	−88.8	−43.0	−73.0	−136.6	−178.7	−936.0	−1,457.7
Off-Budget [a]	−0.9	−0.4	−0.2	*	0.5	3.9	5.1	4.2	3.7	3.3	−1.1	19.3
CHANGES IN DIRECT SPENDING												
Tax Reform for Individuals:												
Estimated Budget Authority	−11.7	3.6	3.4	3.1	2.5	3.5	−3.4	−4.3	−4.8	−4.2	1.6	−12.2
Estimated Outlays	−11.7	3.6	3.4	3.1	2.5	3.5	−3.4	−4.3	−4.8	−4.2	1.6	−12.2
Business Tax Reform:												
Estimated Budget Authority	2.2	2.3	1.7	1.9	1.8	−0.1	−0.1	−0.1	−0.1	−0.1	10.1	9.7
Estimated Outlays	2.2	2.3	1.7	1.9	1.8	−0.1	−0.1	−0.1	−0.1	−0.1	10.1	9.7
Taxation of Foreign Income and Foreign Persons:												
Estimated Budget Authority	0.3	0.1	0.1	0.1	0.1	*	0	0	0	0	0.8	0.9
Estimated Outlays	0.3	0.1	0.1	0.1	0.1	*	0	0	0	0	0.8	0.9
Total Changes in Direct Spending												
Estimated Budget Authority	−9.2	6.0	5.2	5.1	4.4	3.4	−3.5	−4.4	−4.9	−4.3	12.5	−1.6
Estimated Outlays	−9.2	6.0	5.2	5.1	4.4	3.4	−3.5	−4.4	−4.9	−4.3	12.5	−1.6
NET INCREASE OR DECREASE (−) IN THE DEFICIT FROM CHANGES IN DIRECT SPENDING AND REVENUES												
Impact on Deficit	108.4	227.0	221.7	203.3	188.9	88.3	34.4	64.4	128.0	171.1	949.6	1,436.8
On-Budget Deficit	107.5	226.6	221.5	203.3	189.4	92.2	39.5	68.6	131.7	174.4	948.5	1,456.1
Off-Budget Deficit	0.9	0.4	0.2	*	−0.5	−3.9	−5.1	−4.2	−3.7	−3.3	1.1	−19.3

Source: Staff of the Joint Committee on Taxation.
Note: Components may not add to totals due to rounding; * = between −$50 million and $50 million.
[a]. Off-budget revenues result from changes in Social Security payroll tax receipts.

Tax Reform for Individuals. H.R. 1 would make numerous changes to tax law pertaining to individuals. Provisions in this section include all of those in Title I of the bill and the part of Title II pertaining to the individual alternative minimum tax. Such provisions estimated to reduce revenues over the 2018 to 2027 period include the following changes, which would take effect in 2018 unless otherwise noted:

- Establish four brackets instead of the seven in place under current law, with tax rates of 12 percent, 25 percent, 35 percent, and 39.6 percent, plus a phase out of the 12 percent tax bracket for taxpayers with taxable income above $1 million ($1.2 million for joint filers);
- Increase the standard deduction;
- Repeal the alternative minimum tax on individuals;
- Establish a maximum tax rate of 25 percent for qualified business income of an individual from certain pass-through entities, namely partnerships, S corporations, and sole proprietorships;
- Increase the child tax credit, which would be consolidated into a new family tax credit that would also include a temporary $300 credit for each taxpayer (including both spouses for joint filers) and nonchild dependents; and
- Double the exemption amount allowed under estate and gift taxes, and, starting in 2025, repeal the estate tax and the generation-skipping transfer tax.

Provisions estimated to increase revenues over the 2018 to 2027 period include the following changes:

- Repeal deductions for personal exemptions;
- Repeal and limit certain itemized deductions, including repealing the deductions for state and local income and sales taxes, limiting the deduction for real property taxes, and limiting the deductions for mortgage interest; and
- Index tax parameters by the chained consumer price index instead of the traditional consumer price index.

JCT estimates that the individual tax provisions would, on net, reduce revenues by $976 billion from 2018 to 2027. In addition, the provisions would affect outlays for refundable tax credits, decreasing them by an estimated $12 billion over the 2018 to 2027 period. Some of the provisions in this section would affect off-budget revenues, increasing them by $15 billion over the period from 2018 to 2027, JCT estimates. On-budget revenues would decrease by an estimated $991 billion.

The largest revenue reductions would result from the provision to establish a new income tax rate and bracket structure, which JCT estimates would reduce revenues by $1,104 billion over the period from 2018 to 2027 and reduce outlays for refundable tax credits by $15 billion over the same period. In addition, the increase in the standard deduction would reduce revenues by $819 billion over the period from 2018 to 2027 and increase outlays for refundable tax credits by $103 billion over the same period, according to JCT's estimates. The repeal of the alternative minimum tax on individuals would reduce revenues by $696 billion from 2018 to 2027.

JCT also estimates that the provisions providing a maximum tax rate for pass-through entities would reduce revenues by $597 billion over the period from 2018 to 2027, and that modifications to the child tax credit and the new family tax credit would, over the same 10-year period, reduce revenues by $504 billion and increase outlays for refundable tax credits by $136 billion. JCT estimates that additional revenue reductions, totaling $151 billion from 2018 to 2027, would result from the modifications to estate and gift taxes.

The largest revenue increases would result from the provision to repeal deductions for personal exemptions, which JCT estimates would increase revenues by $1,383 billion and reduce outlays for refundable credits by $179 billion over the 2018 to 2027 period. In addition, JCT estimates that the repeal and limitation of certain itemized deductions would increase revenues by $1,258 billion and reduce outlays for refundable credits by $4 billion from 2018 to 2027. The change in the inflation measure used to index tax parameters would increase revenues by $109 billion and reduce outlays for refundable credits by $19 billion over the 2018 to 2027 period, according to JCT estimates.

Business Tax Reform. The bill would make many changes to business taxes. Provisions in this section include all of Title III and the part of Title II pertaining to the corporate alternative minimum tax. The ones with the largest effects on revenues, as estimated by JCT, are the following:

- Replace with a single 20 percent rate the graduated structure of income tax rates for corporations under current law that has a top rate of 35 percent;
- Limit the amount of deductions for net interest expenses to the sum of business interest income and 30 percent of an adjusted measure of taxable income; and
- Limit the deduction for past net operating losses to 90 percent of current taxable income and generally repeal the two-year period over which losses may be carried back to previous tax years.

JCT estimates that the business tax provisions would, on net, reduce revenues by $745 billion from 2018 to 2027. In addition, the provisions would increase outlays for refundable tax credits by an estimated $10 billion over the 2018 to 2027 period.

JCT estimates that the modifications to the corporate tax rate structure, including reducing the top tax rate from 35 percent that is assessed on most taxable income to a 20 percent rate that would apply to all amounts of taxable income, would reduce revenues by $1,456 billion over the 2018–2027 period. JCT further estimates that limiting the deductions for interest expenses would increase revenues by $172 billion over the same 10-year period. In addition, limiting the use of net operating losses would raise revenues by $156 billion over the period from 2018 to 2027.

Other changes to business taxes, including the following ones, would increase revenues, on net, according to JCT:

- Requiring that certain research or experimental expenditures be amortized over a five-year period or longer, starting in 2023, would increase revenues by $109 billion over the period from 2023 to 2027.
- Repealing the deduction for income attributable to domestic production activities would increase revenues by $95 billion over the 2018 to 2027 period;

- Repealing the tax credit for clinical testing expenses for certain drugs for rare diseases or conditions would increase revenues by $54 billion over the same period; and
- Terminating private activity bonds would increase revenues by $39 billion over the next 10 years.

Those increases in revenues would be partially offset by the repeal of the alternative minimum tax on corporations, which JCT estimates would reduce revenues by $30 billion from 2018 to 2027 and increase outlays for refundable credits by $10 billion over the same period.

Taxation of Foreign Income and Foreign Persons. Changes to taxes pertaining to foreign income and foreign persons are contained in Title IV of H.R. 1. The bill would substantially modify the current system under which U.S. corporations are subject to taxation on their worldwide income, generally including foreign earnings in taxable income when paid to them as dividends by their foreign subsidiaries and with an allowance for tax credits for certain foreign taxes paid. The system under H.R. 1 would provide an exemption for dividends paid by a foreign corporation to its U.S. parent, with no foreign tax credits allowed for taxes paid on the amount of such dividends. A number of other changes would also be implemented by Title IV.

The provisions in Title IV with the largest estimated effects on revenues are the following:

- Require that certain untaxed foreign income of U.S. corporations be deemed to be immediately paid to them as dividends and included in taxable income, subject to taxation at a 14 percent rate (or 7 percent for certain illiquid assets), and with an option to spread the resulting tax amounts equally over an eight-year period;
- Provide a deduction for the foreign-source portion of dividends received by domestic corporations from certain foreign corporations;
- Impose an excise tax of 20 percent on certain payments to related foreign corporations; and
- Require that U.S. corporations include in taxable income a portion of a specified high income amount earned by their foreign subsidiaries.

JCT estimates that the provisions related to foreign taxation would, on net, increase revenues by $279 billion from 2018 to 2027. The provisions would also increase outlays by $1 billion over the 2018 to 2027 period, resulting from an extension of certain payments to Puerto Rico and the Virgin Islands of rum excise taxes, as estimated by CBO.

JCT estimates that the deduction for dividends received from foreign corporations would reduce revenues by $205 billion over the 2018–2027 period. Other provisions would result in revenue increases from 2018 to 2027 as estimated by JCT: requiring a deemed repatriation of untaxed foreign income ($293 billion); imposing an excise tax on certain payments ($95 billion); and requiring the inclusion in taxable income of certain foreign earned high returns ($68 billion). The additional revenue from the provision regarding deemed repatriations would be concentrated earlier in the ten-year period: it would increase revenues by an estimated $79 billion in 2018, $54 billion in 2019, between $26 billion and $27 billion per year from 2020 through 2025, and $9 billion in 2026, before resulting in a reduction in revenue of $8 billion in 2027.

Exempt Organizations. Title V of H.R. 1 would make several changes to the tax treatment of tax-exempt organizations. Those changes include the following: imposing an excise tax based on the investment income of private colleges and universities; revising the unrelated business income tax; and modifying restrictions on political campaign activity for certain tax-exempt organizations. JCT estimates that the changes from Title V would, on net, increase revenues by $0.5 billion or less in each year of the 2018 to 2027 period, for a total increase of $3 billion over the 10-year period. No single provision would have an effect of greater than $0.5 billion in any year, according to JCT estimates.

Pay-As-You-Go considerations: The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. The net changes in outlays and revenues that are subject to those pay-as-you-go procedures are shown in the following table. Only on-budget changes to outlays or revenues are subject to pay-as-you-go procedures.

CBO ESTIMATE OF PAY-AS-YOU-GO EFFECTS FOR H.R. 1, AS ORDERED REPORTED BY THE HOUSE COMMITTEE ON WAYS AND MEANS ON NOVEMBER 9, 2017

	By fiscal year, in billions of dollars—											
	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018–2022	2018–2027
NET INCREASE OR DECREASE (−) IN THE ON-BUDGET DEFICIT												
Statutory Pay-As-You-Go Effects	107.5	226.6	221.5	203.3	189.4	92.2	39.5	68.6	131.7	174.4	948.5	1,456.1
Memorandum:[a]												
Change in Outlays	−9.2	6.0	5.2	5.1	4.4	3.4	−3.5	−4.4	−4.9	−4.3	12.5	−1.6
Change in On-Budget Revenues	116.7	−220.6	−216.3	−198.2	−185.0	−88.8	−43.0	−73.0	−136.6	−178.7	−936.0	−1,457.7

Source: Staff of the Joint Committee on Taxation.

[a] A positive sign for outlays indicates an increase in outlays. A negative sign for revenues indicates a reduction in revenues.

Note: Components do not add to totals due to rounding.

Increase in long term direct spending: JCT estimates that enacting the legislation would not increase net direct spending by more than $2.5 billion in any of the four consecutive 10-year periods beginning in 2028.

Mandates: JCT has determined that H.R. 1 contains no private-sector or intergovernmental mandates as defined by UMRA.

Estimate prepared by: Staff of the Joint Committee on Taxation and Cecilia Pastrone from the Congressional Budget Office.

Estimate approved by: John McClelland, Assistant Director for Tax Analysis.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE RULES OF THE HOUSE

A. Committee Oversight Findings and Recommendations

With respect to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee made findings and recommendations that are reflected in this report.

B. Statement of General Performance Goals and Objectives

With respect to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee advises that the bill contains no measure that authorizes funding, so no statement of general performance goals and objectives for which any measure authorizes funding is required.

C. Information Relating to Unfunded Mandates

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995 (Pub. L. No. 104–4).

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

D. Tax Complexity Analysis

Section 4022(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 ("IRS Reform Act") requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service and the Treasury Department) to provide a tax complexity analysis. The complexity analysis is required for all legislation reported by the Senate Committee on Finance, the House Committee on Ways and Means, or any committee of conference if the legislation includes a provision that directly or indirectly amends the Internal Revenue Code of 1986 and has widespread applicability to individuals or small businesses.

Pursuant to clause 3(h)(1) of rule XIII of the Rules of the House of Representatives, for each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided below along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and Treasury regarding each provision included in the complexity analysis.

1. Simplification of rates, standard deduction, personal exemption (secs. 1001, 1002, 1003 and 1004 of the bill)

Summary description of the provisions

The bill changes the structure of the individual income tax by modifying the rate structure such that there are only four tax brackets (12-percent, 25-percent, 35-percent and 39.6-percent), significantly increasing the size of the standard deduction (for 2018 the standard deduction is $24,400 for joint filers, $18,300 for heads of household and $12,200 for other filers), and eliminating personal exemptions.

Number of affected taxpayers

It is estimated that the provision will affect approximately 120 million tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to these provisions. It should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision.

The IRS will need to adjust its wage withholding tables to reflect the repeal of personal exemptions. Because revised wage withholding will occur within the first month of 2018, this would require employers to switch to new withholding tables somewhat quickly, which can be expected to result in a one-time additional burden for employers (or potential additional costs for employers that rely on a bookkeeping or payroll service).

Some taxpayers who currently itemize deductions may respond to the provision by claiming the increased standard deduction in lieu of itemizing. According to estimates by the staff of the Joint Committee on Taxation, approximately 94 percent of taxpayers will claim the standard deduction under the bill, up from approximately 70 percent under present law. These taxpayers will no longer have to file Schedule A to Form 1040, a significant number of which will no longer need to engage in the record keeping inherent in itemizing below-the-line deductions. Moreover, by claiming the standard deduction, such taxpayers may qualify to use simpler versions of the Form 1040 (i.e., Form 1040EZ or Form 1040A) that are not available to individuals who itemize their deductions. These forms simplify the return preparation process by eliminating from the Form 1040 those items that do not apply to particular taxpayers.

This reduction in complexity and record keeping also may result in a decline in the number of individuals using a tax preparation service, or tax preparation software, or a decline in the cost of such service or software. The provision also should reduce the number of disputes between taxpayers and the IRS regarding the substantiation of itemized deductions.

2. Reduced rate for small businesses with net active business income

Under the bill, a special rule provides a reduced tax rate of 11, 10, or nine percent in the case of an individual's qualified active business income below an indexed threshold of $75,000 (in the case of a joint return or a surviving spouse). The indexed $75,000 threshold is three quarters of that amount for individuals filing as head of household and half that amount for other individuals. The reduced rate is not available to estates and trusts.

The reduced rate is phased in. The reduced rate is 11 percent (that is, one percentage point below the 12 percent rate) for taxable years beginning in 2018 and 2019, and is 10 percent (that is, two percentage points below the 12 percent rate) in 2020 and 2021. For taxable years beginning in 2022 and thereafter the reduced rate is nine percent.

The reduced tax rate applies to the least of three amounts, the taxpayer's: (1) qualified active business income, (2) taxable income reduced by net capital gain, or (3) 9-percent bracket threshold amount (described above). Qualified active business income means the excess of the taxpayer's net business income from any active business activity over his or her net business loss from any active business activity. Qualified active business income includes income from any trade or business activity, including service businesses. No capital percentage limitation applies in determining qualified active business income.

A phase-out applies to the amount subject to the 11-, 10-, or nine-percent rate. The amount taxed at one of these rates is reduced by the excess of taxable income over an indexed applicable threshold amount, $150,000 in the case of married individuals filing jointly. The applicable threshold amount is three quarters of that amount for individuals filing as head of household and half that amount for other individuals.

An active business activity is an activity that involves the conduct of any trade or business and that is not a passive activity for purposes of the passive loss rules of section 469 (that is, generally, the taxpayer materially participates in the trade or business activity).

Number of affected taxpayers

It is estimated that the provision will affect over ten percent of small business tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. It should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. It may, however, increase the number of questions that taxpayers ask the IRS, such as how to calculate qualified active business income. This increased volume of questions could have an adverse impact on other elements of IRS' operation, such as the levels of taxpayer service. The provision should not increase the tax preparation costs for most individuals.

The IRS will need to add to the individual income tax forms package a new worksheet so that taxpayers can calculate their qualified active business income. This worksheet will require a series of calculations.

3. Increase in child tax credit and addition of new family credit exemption (sec. 1101 of the bill)

Summary description of the provisions

The bill increases the value of the child tax credit to $1,600, providing that no more than $1,000 per child shall be refundable. This $1,000 limitation is indexed and rounded up, such that in 2018 it is $1,100. In order to qualify for the child tax credit, a Social Security number must be provided for the qualifying child. The bill also provides a $300 nonrefundable tax credit for the taxpayer, the taxpayer's spouse, and any dependent other than a qualifying child. This credit expires for taxable years beginning after December 31, 2022.

Number of affected taxpayers

It is estimated that the provision will affect approximately 90 million tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to these provisions. It should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. The provision may, however, increase the number of questions that taxpayers ask the IRS, such as whether they may claim the new family credit for certain members of their household, or whether and to what extent the combined tax credit is refundable.

The IRS will need to modify its forms and publications to reflect this change.

4. Repeal of the deduction for State and local income taxes (sec. 1303 of the bill)

Summary description of the provisions

Under the provision, in the case of an individual, as a general matter, State, local and foreign property taxes and State and local sales taxes are allowed as a deduction only when paid or accrued in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income). Thus, the provision allows only those deductions for State, local and foreign property taxes, and sales taxes, that are presently deductible in computing income on an individual's Schedule C, Schedule E, or Schedule F on such individual's tax return.

The provision contains an exception to the above-stated rule in the case of real property taxes. Under this exception, an individual may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for property taxes paid or accrued in the taxable year, in addition to any property taxes deducted in carrying on a trade or business or an activity described in section 212. Foreign real property taxes may not be deducted under this exception.

Under the provision, in the case of an individual, State and local income, war profits, and excess profits taxes are not allowable as a deduction.

Number of affected taxpayers

It is estimated that the provision will affect approximately 44 million tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. Because the deduction for State and local taxes has been longstanding in the Code, its repeal may require regulatory guidance, so as to provide guidance for taxpayers regarding which taxes remain properly deductible on an individual's Schedule C, Schedule E or Schedule F. This may also result in an increase in disputes with the IRS.

Additionally, if a technical correction is made to remove the reporting requirement regarding State and local refunds of income tax, this would relieve those jurisdictions with a reporting obligation of the cost of complying with this obligation, as well as reduce the need for taxpayers to retain such reports for their books and records.

The IRS will need to modify its forms and publications to reflect this change

5. Increased expensing

The bill extends and modifies the additional first-year depreciation deduction through 2022 (through 2023 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property acquired and placed in service after September 27, 2017, and before January 1, 2023 (January 1, 2024, for longer production period property and certain aircraft), as well as for specified plants planted or grafted after September 27, 2017, and before January 1, 2023. The $8,000 increase amount in the limitation on the depreciation deductions allowed with respect to certain passenger automobiles is increased to $16,000 for passenger automobiles acquired and placed in service after September 27, 2017, and before January 1, 2023.

The bill maintains the present law phase-down of bonus depreciation and the section 280F increase amount for property acquired before September 28, 2017, and placed in service after September 27, 2017.

The bill extends the special rule under the percentage-of-completion method for the allocation of bonus depreciation to a long-term contract for property placed in service before January 1, 2023 (January 1, 2024, in the case of longer production period property).

The bill removes the requirement that the original use of qualified property must commence with the taxpayer. Thus, the additional first-year depreciation deduction applies to purchases of used as well as new items.

The bill excludes from the definition of qualified property any property used (i) in a real property trade or business, (ii) in the trade or business of certain regulated public utilities, and (iii) in a trade or business that has had floor plan financing indebtedness unless the taxpayer with such trade or business is not a tax shelter precluded from using the cash method and is exempt from the interest limitation rules in section 3301 of the bill by satisfying the $25 million gross receipts test of section 448(c).

As a conforming amendment to the repeal of AMT, the bill repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Number of affected taxpayers

It is estimated that the provision will affect over ten percent of small business tax returns.

Discussion

The reporting requirements are unchanged by this provision. Capital assets purchased during the tax year will still need to be reported on Form 4562, Depreciation and Amortization (Including Information on Listed Property); however, the current year tax deduction associated with such assets will increase.

6. Expansion of section 179 expensing

The bill increases the maximum amount a taxpayer may expense under section 179 to $5 million and increases the phase-out threshold amount to $20 million for five taxable years (*i.e.,* for taxable years beginning in 2018, 2019, 2020, 2021, and 2022). The $5,000,000 and $20,000,000 amounts are indexed for inflation for taxable years beginning after 2018.

The bill expands the definition of qualified real property under section 179 to include qualified energy efficient heating and air-conditioning property acquired and placed in service by the taxpayer after November 2, 2017.

Number of affected taxpayers

It is estimated that the provision will affect over ten percent of small business tax returns.

Discussion

While taxpayers purchasing section 179 property will still be required to complete and file Form 4562, Depreciation and Amortization (Including Information on Listed Property), significantly less detail is required to be included on such form. Accordingly, the compliance burden of many taxpayers will be reduced.

E. Congressional Earmarks, Limited Tax Benefits, and Limited Tariff Benefits

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

F. Duplication of Federal Programs

In compliance with clause 3(c)(5) of Rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

G. Disclosure of Directed Rule Makings

In compliance with Sec. 3(i) of H. Res. 5 (115th Congress), the bill contains the following directed rulemakings:

Section 1311 directs the Secretary of the Treasury to issue regulations related to the termination of deduction and exclusions for contributions to medical savings accounts.

Section 1503 directs the Secretary of the Treasury to modify Treasury Regulation section 1.401(k)–1(d)(3)(iv)(E).

Section 3307 directs the Secretary of the Treasury to issue regulations relating to entertainment and fringe-benefit expenses.

Section 3314 directs the Secretary of the Treasury to issue regulations to the recharacterization of certain gains in the case of partnership profits interests held in connection with performance of investment services.

Section 3802, addressing an excise tax on excess tax-exempt organization executive compensation, directs the Secretary of the Treasury to issue regulations as necessary to prevent avoidance of the purposes of this section through the performances of services other than as an employee.

Section 4301, addressing current year inclusion by United States shareholders with foreign high returns, directs the Secretary of the Treasury to issue regulations as the Secretary determines appropriate to prevent the avoidance of the purposes of this section.

VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

With respect to clause 3(e) of rule XIII of the Rules of the House of Representatives, the Committee advises that compliance prior to consideration was not possible.

VII. DISSENTING VIEWS

The Tax Cuts and Jobs Act, H.R. 1, is a bad deal for millions of Americans, particularly the middle class. The legislation puts the wealthy and well-connected first, while forcing millions of American families to watch as their taxes go up at every stage of their lives—from childhood to retirement. That's simply not what the American people asked us to do, and it is not something that the Democrats on this Committee can support.

Committee Democrats unanimously opposed H.R. 1 at the markup, because the legislation disproportionately benefits the wealthy and big corporations over hardworking taxpayers who are struggling with the rising costs of education, housing, and other expenses, not to mention the challenges of saving for retirement. Under H.R. 1, nearly one-half of all middle-class families would pay more taxes in 2026 than they would under current law, and about one-third would pay more in 2018. As the Wall Street Journal said this week, this is "a middle class tax cut that is really a hike."

The Tax Cuts and Jobs Act would hurt middle-class families with children

Rather than provide meaningful assistance to families with children through a much-needed expansion to the Child Tax Credit (CTC), the Republican bill prioritizes tax cuts to wealthy individuals. In fact, the Center on Budget and Policy Priorities estimated that the expanded CTC contained in H.R. 1 would leave out 10 million children in low-wage working families and another roughly 13 million children in low- and modest-income working families would receive something less than the full $600 per-child credit increase. By making the CTC increase nonrefundable, many families would simply not benefit.

The Tax Cuts and Jobs Act would hurt students and teachers

Our schools are woefully underfunded and students suffer because of it. When their supplies budgets run out (often well before securing essential items like books and paper), many teachers buy supplies for their classrooms with money out of their own pockets. H.R. 1 removes the tax credit these teachers receive for buying these classroom supplies. A survey conducted during the 2015–16 school year found that teachers spend an average of $600 on classroom supplies and materials every year. The current law above-the-line deduction gives them some of that money back. While corporations can deduct the costs of paper and pencils as necessary business expenses, H.R. 1 would take away that ability from teachers across America.

H.R. 1 also harms students. It would repeal two tax credits for students: the Lifetime Learning Credit and Hope Scholarship Credit. The loss of these tax credits alone would cost low- and middle-income students $17 billion over the next decade. While the bill does put into place a one-year extension of the American Opportunity Tax Credit (AOTC), it is less generous than the two tax credits lost plus the extension is only temporary. Under H.R. 1, the AOTC is cut in one-half after four years, which would make the maximum credit $1,250 for the fifth year of education.

Once out of school, H.R. 1 also removes the student loan interest deduction. Currently, student loan borrowers can deduct up to $2,500 of interest paid on student loans. In 2015, more than 12 million people claimed the student loan interest deduction.

For students who work, the bill eliminates the tax-free status of employer tuition reimbursements. A 2013 employer survey found that 61 percent of companies make available some type of tuition-assistance program. While H.R. 1 provides big corporations with extensive tax breaks, the Republicans chose to tax middle-class workers when they benefit from tuition reimbursement programs.

The Tax Cuts and Jobs Act would hurt middle-class Americans and threaten state and local government services

H.R. 1 harms middle-class Americans by repealing the state and local tax (SALT) deduction for individuals, except for a property tax deduction capped at $10,000. The SALT deduction prevents taxpayers from owing federal taxes on the income they pay in taxes to state and local governments. State and local tax payments are not disposable income, and it is unfair to treat them as such. The SALT deduction is so common-sense that it has been in force since the first federal income tax, adopted more than a century ago, when the whole federal income tax law was three pages long.

Ironically, H.R. 1 would allow corporations to continue deducting state and local taxes, while eliminating much of the benefit for individuals and families.

Currently, more than 100 million Americans in 44 million households claim the SALT deduction. Almost 40 percent of taxpayers earning between $50,000 and $75,000 claim SALT, and over 70 percent of taxpayers making $100,000 to $200,000 use it. Over one-half the value of the deduction went to households with incomes below $200,000. People living in every congressional district in every state in the country use this deduction, and it benefits taxpayers of all income levels, directly or indirectly.

Two-thirds of state and local government spending comes from its income and sales taxes. These revenues support essential public services investments, like schools, local law enforcement, fire fighters, road construction and maintenance, and health care. Nearly everyone who itemizes claims the SALT deduction; therefore, repealing SALT would raise the cost of state and local services on a wide swath of taxpayers. This would pressure state and local governments to reduce revenues and cut crucial public investments.

The Tax Cuts and Jobs Act would hurt homeowners and home values

H.R. 1 would hurt homeowners. The American Dream has long included the idea of home ownership but H.R. 1 scales back the tax benefit of buying a new home. It also eliminates private activity bonds, which are key for financing affordable housing. That's why groups like the National Association of Home Builders (NAHB) oppose this bill. H.R. 1 depresses home ownership and home values. The bill cuts the amount people can claim as mortgage interest deductions so that only those people who can afford large down payments can afford to buy homes—especially in coastal cities where home prices are very high. Also, because the bill discourages itemized deductions, many who can now deduct modest mortgage interest will see no tax benefit from that deduction. For many potential homeowners, buying a home will be no better than renting, and they will leave the market. Current home owners will have a smaller pool of buyers to sell to and their home values—the primary source of wealth for middle-class Americans—will decline. According to NAHB President Granger MacDonald, "The House Republican tax reform plan abandons middle-class taxpayers in favor of high-income Americans and wealthy corporations. The bill eviscerates existing housing tax benefits by drastically reducing the number of home owners who can take advantage of mortgage interest and property tax incentives." National Association of Realtors President William E. Brown agreed, "The nation's 1.3 million Realtors cannot support a bill that takes homeownership off the table for millions of middle-class families."

The Tax Cuts and Jobs Act would hurt older Americans

H.R. 1 repeals the medical expense deduction, effectively creating a new Health Tax on older and sick Americans. This Health Tax would result in a tax increase for millions of Americans with high medical costs, especially older Americans. The end result is a massive tax increase for older Americans and individuals living with expensive illnesses—like cancer, Alzheimer's, or a rare disease—to pay for corporate tax cuts.

The medical expense deduction is particularly important for older Americans. Over 73 percent of those claiming the tax credit are over 50 years old, and 55 percent are over 65 years old. One-half of those claiming the tax credit have incomes below $50,000.

The Affordable Care Act helped lower the number of Americans facing medical debt by giving millions health insurance coverage for the first time. However, a severe illness or even medical bills from a car accident, can still mount to thousands of dollars. For the family caring for a premature child, the couple trying to conceive, or the husband caring for a wife diagnosed with Alzheimer's, this deduction is one way to help prevent medical bills from crushing families in debt.

For all of these reasons and more, we oppose The Tax Cuts and Jobs Act

The middle class in this country are struggling. In passing tax reform, we must take those Americans who feel forgotten and left behind into consideration and build a tax code founded on fairness. This bill simply does not.

Instead, H.R. 1 lets the American people down at every step of their life—from birth through retirement. It fails to provide the needed improvements to the tax code that could assist the hopeful young family trying to keep their head above water; the student trying to do the right thing by getting an education; and the factory worker at the end of a long career just hoping to have enough left over to retire with dignity. Democrats believe that instead of pulling down the ladder of opportunity for those in the middle class, and the millions who aspire to it, we should expand it to make sure that everyone has a fair shot.

The secret, closed door negotiations produced a deeply flawed bill that will hurt the teacher that spends her own money to buy school supplies for their students; students trying to responsibly pay back their student loans; the wife trying to afford her husband's Alzheimer's care; and the janitor who wants to retire with dignity so he can spoil his grandchildren.

American families should not be forced watch as the rich get richer, and they fall further and further behind. H.R. 1 would do just that.

RICHARD E. NEAL,
Ranking Member.

ADDITIONAL VIEWS

In addition to the facts outlined by the Ranking Member, the record must be clear: H.R. 1 is not long-awaited, once-in-a-generation, bipartisan tax reform. This bill ignores long-standing inequities in tax law and fails to simplify the tax code. Instead, this legislation meticulously selects winners and losers. Simply said, H.R. 1 robs poor Peter to pay billionaire Paul.

H.R. 1 features deficit-creating tax cuts and irresponsible policy changes. Some proposals are straightforward. For example, the assault on the elderly, disabled, teachers, caretakers, and immigrant families is a flagrant and heartless attempt to find revenue to pay for corporate tax cuts. Workers would lose employer-supported training and education benefits. Changes to the mortgage interest deduction and the deductibility of state and local taxes would cause unnecessary harm to both taxpayers and local governments.

Unfortunately, the impact of other amendments in this bill are much more difficult to decipher. H.R. 1 shifts tax provisions and timelines in a manner that will force individuals and communities to spend hours, days, weeks, months, and resources calculating their real losses and gains. Sadly, this bill neglects Congress' core constitutional responsibility to develop sound fiscal policy, which serve all American taxpayers, not just a select few. There are serious challenges facing our country like affordable housing, veterans' services, transportation financing, and student debt, which should be core components of any legislation intended to serve as a compass for a generation of policy makers.

An example of how H.R. 1 further complicates the tax code is the bill's impact on those seeking to improve their lives through the pursuit of higher education. As students of all ages struggle to compete in a 21st Century workforce and face increased burden of debt, the education tax provisions of this bill create an additional and perhaps insurmountable hurdle; it exacerbates an already dire situation. As graduate students in Metro Atlanta and across the country began to review H.R. 1, they learned the tax changes would only exacerbate their financial woes. This is a grave and serious issue for my Congressional District, which has many outstanding colleges and universities. One student calculated her individual net loss to be at least $550 per month. Many others fear that if Congress passes this legislation, a graduate degree would no longer be within their reach. This is unconscionable and unacceptable.

It is also important to examine the holistic impact of this legislation on aging cities and counties that are struggling to revitalize their communities. Notably, the effect of eliminating the new markets tax credit and the historic rehabilitation tax credit—combined with changes to private activity bonds and limitations on the ability of State and local governments to offer incentives to recruit new businesses—would devastate major community development, housing, transportation, water and sewer, and health initiatives. Make no mistake—H.R. 1 will cripple policy makers at every level of government.

Finally, this bill is a disservice to the role of Congress and the legacy of our predecessors who put the good of our nation ahead of a select few. In 1913, the United States ratified the Sixteenth Amendment to the U.S. Constitution; this amendment allowed Congress to develop legislation to tax income. Congress developed subsequent revenue bills—the Revenue Act of 1913 and the War Revenue Act of 1917—that featured core standards. These included encouraging the best of humanity through charitable and philanthropic endeavors and ensuring that future generations did not bear the burden of the financial costs of war. H.R. 1 undermines both of these principles.

Since the Republican Majority developed and rushed this bill through committee without congressional review or bipartisan input, certain provisions are untested and could cause irreparable damage. Upon examining H.R. 1, the non-partisan Joint Committee on Taxation reported the bill would result in $94.8 billion less in charitable contribution deductions. This legislation pays tribute to the 100th anniversary of the charitable contribution deduction by proposing policies that will result in a 40 percent decline of its usage. This bill turns the clock back on a century of progress.

Some of the most blatant examples of dangerous, undemocratic policy include this bill's impact on charitable and faith-based institutions. Alarmingly, section 5201 of H.R. 1 would repeal the "Johnson Amendment," a 53-year standard that prohibits religious and philanthropic organizations from engaging in political activities. The Joint Committee on Taxation estimates this policy change would increase the deficit by $2.1 billion. The bill would create a loophole in campaign finance laws and increase tax-exempt political contributions. Not only did the Majority reject efforts to strip this costly provision, but the Chair also expanded section 5201 to include all 501(c)3 (e.g. religious, nonprofit, and charitable) organizations at the end of the Committee markup. Faith-based, philanthropic, charitable, and transparency groups in every State of our country overwhelmingly oppose this dangerous policy change.

H.R. 1 ignores the grave reality that the United States is engaged in the longest wars in history, for which sadly there is no end in sight. Last week, Brown University's Cost of War Project reported that the current wars in Afghanistan, Iraq, Syria, and Pakistan cost at least $5.6 trillion or $23,386 per taxpayer. Never before has Congress directly and repeatedly shirked its responsibility to finance U.S. participation in war. For 16 years, brave service members put their lives on the line and their families on hold to protect and serve our nation, as Congress fails to do our part. Instead, H.R. 1 continues to pay for these wars on a credit card. Not only does H.R. 1 neglect to address this grave matter, but it will also finance these irresponsible corporate tax cuts through massive reductions to safety net programs and non-defense discretionary programs upon which all Americans—including veterans and military families—rely.

The record must be clear; H.R. 1 is not tax reform. This legislation does not simplify the tax code. It does not give hope and opportunity to those who strive to realize the American dream. It does not rectify long-standing injustices within U.S. tax law. Instead, this unprecedented and negligent legislation puts the gains of a select few ahead of the best interests of our children, grandchildren, and generations yet unborn.

JOHN LEWIS.

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