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Senate

The Senate was not in session today. Its next meeting will be held on Monday, December 18, 2017, at 3 p.m.

House of Representatives

FRIDAY, DECEMBER 15, 2017

The House met at 5:30 p.m. and was called to order by the Speaker pro tempore (Mr. SIMPSON).

DESIGNATION OF THE SPEAKER PRO TEMPORE

The SPEAKER pro tempore laid before the House the following communication from the Speaker:

WASHINGTON, DC,
December 15, 2017.

I hereby appoint the Honorable MICHAEL K. SIMPSON to act as Speaker pro tempore on this day.

PAUL D. RYAN,
Speaker of the House of Representatives.

PRAYER

Reverend Dr. Dan C. Cummins, Peoples Church, Jacksonville, Texas, offered the following prayer:

Our Father in Heaven, during this Christmas season may we remember it is better to give than to receive. And the best gift is the one given to those who cannot repay.

And let us remember the homeless this holiday season, for so was our Savior's family on the night of his birth.

And while the world went to be taxed, God taught the world about giving your best to perfect strangers, for in so doing we may be entertaining angels unaware.

And like the wise men, let us never consider the distance or difficulty of our journey to offer our gifts to the King. And may we follow the example of this King, who being the very image of God, humbled himself to save others, laying down his life on the cross for their sin. That was the most perfect Christmas gift of all.

In Jesus' name I pray.

Amen.

THE JOURNAL

The SPEAKER pro tempore. The Chair has examined the Journal of the last day's proceedings and announces to the House his approval thereof.

Pursuant to clause 1, rule I, the Journal stands approved.

PLEDGE OF ALLEGIANCE

The SPEAKER pro tempore. Will the gentleman from Texas (Mr. BRADY) come forward and lead the House in the Pledge of Allegiance.

Mr. BRADY of Texas led the Pledge of Allegiance as follows:

I pledge allegiance to the Flag of the United States of America, and to the Republic for which it stands, one nation under God, indivisible, with liberty and justice for all.

CONFERENCE REPORT ON H.R. 1, TAX CUTS AND JOBS ACT

Mr. BRADY of Texas submitted the following conference report and statement on the bill (H.R. 1) to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018:

CONFERENCE REPORT (H. REPT. 115–466)

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 1), to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

TITLE I

SEC. 11000. SHORT TITLE, ETC.

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

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this title 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.

Subtitle A—Individual Tax Reform

PART I—TAX RATE REFORM

SEC. 11001. MODIFICATION OF RATES.

(a) IN GENERAL.—Section 1 is amended by adding at the end the following new subsection:

''(j) MODIFICATIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—

''(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

''(A) subsection (i) shall not apply, and

''(B) this section (other than subsection (i)) shall be applied as provided in paragraphs (2) through (6).

''(2) RATE TABLES.—

''(A) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—The following table shall be applied in lieu of the table contained in subsection (a):

"If taxable income is:	The tax is:
Not over $19,050	10% of taxable income.
Over $19,050 but not over $77,400	$1,905, plus 12% of the excess over $19,050.
Over $77,400 but not over $165,000	$8,907, plus 22% of the excess over $77,400.
Over $165,000 but not over $315,000	$28,179, plus 24% of the excess over $165,000.
Over $315,000 but not over $400,000	$64,179, plus 32% of the excess over $315,000.
Over $400,000 but not over $600,000	$91,379, plus 35% of the excess over $400,000.
Over $600,000	$161,379, plus 37% of the excess over $600,000.

''(B) HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (b):

"If taxable income is:	The tax is:
Not over $13,600	10% of taxable income.
Over $13,600 but not over $51,800	$1,360, plus 12% of the excess over $13,600.
Over $51,800 but not over $82,500	$5,944, plus 22% of the excess over $51,800.
Over $82,500 but not over $157,500	$12,698, plus 24% of the excess over $82,500.
Over $157,500 but not over $200,000	$30,698, plus 32% of the excess over $157,500.
Over $200,000 but not over $500,000	$44,298, plus 35% of the excess over $200,000.
Over $500,000	$149,298, plus 37% of the excess over $500,000.

''(C) UNMARRIED INDIVIDUALS OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS.—The following table shall be applied in lieu of the table contained in subsection (c):

"If taxable income is:	The tax is:
Not over $9,525	10% of taxable income.
Over $9,525 but not over $38,700	$952.50, plus 12% of the excess over $9,525.
Over $38,700 but not over $82,500	$4,453.50, plus 22% of the excess over $38,700.
Over $82,500 but not over $157,500	$14,089.50, plus 24% of the excess over $82,500.
Over $157,500 but not over $200,000	$32,089.50, plus 32% of the excess over $157,500.
Over $200,000 but not over $500,000	$45,689.50, plus 35% of the excess over $200,000.
Over $500,000	$150,689.50, plus 37% of the excess over $500,000.

''(D) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—The following table shall be applied in lieu of the table contained in subsection (d):

"If taxable income is:	The tax is:
Not over $9,525	10% of taxable income.
Over $9,525 but not over $38,700	$952.50, plus 12% of the excess over $9,525.
Over $38,700 but not over $82,500	$4,453.50, plus 22% of the excess over $38,700.
Over $82,500 but not over $157,500	$14,089.50, plus 24% of the excess over $82,500.
Over $157,500 but not over $200,000	$32,089.50, plus 32% of the excess over $157,500.
Over $200,000 but not over $300,000	$45,689.50, plus 35% of the excess over $200,000.
Over $300,000	$80,689.50, plus 37% of the excess over $300,000.

''(E) ESTATES AND TRUSTS.—The following table shall be applied in lieu of the table contained in subsection (e):

"If taxable income is:	The tax is:
Not over $2,550	10% of taxable income.
Over $2,550 but not over $9,150	$255, plus 24% of the excess over $2,550.
Over $9,150 but not over $12,500	$1,839, plus 35% of the excess over $9,150.
Over $12,500	$3,011.50, plus 37% of the excess over $12,500.

''(F) REFERENCES TO RATE TABLES.—Any reference in this title to a rate of tax under subsection (c) shall be treated as a reference to the corresponding rate bracket under subparagraph (C) of this paragraph, except that the reference in section 3402(q)(1) to the third lowest rate of tax applicable under subsection (c) shall be treated as a reference to the fourth lowest rate of tax under subparagraph (C).

''(3) ADJUSTMENTS.—

''(A) NO ADJUSTMENT IN 2018.—The tables contained in paragraph (2) shall apply without adjustment for taxable years beginning after December 31, 2017, and before January 1, 2019.

''(B) SUBSEQUENT YEARS.—For taxable years beginning after December 31, 2018, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in paragraph (2) in the same manner as under paragraphs (1) and (2) of subsection (f) (applied without regard to clauses (i) and (ii) of subsection (f)(2)(A)), except that in prescribing such tables—

''(i) subsection (f)(3) shall be applied by substituting 'calendar year 2017' for 'calendar year 2016' in subparagraph (A)(ii) thereof,

''(ii) subsection (f)(7)(B) shall apply to any unmarried individual other than a surviving spouse or head of household, and

''(iii) subsection (f)(8) shall not apply.

''(4) SPECIAL RULES FOR CERTAIN CHILDREN WITH UNEARNED INCOME.—

''(A) IN GENERAL.—In the case of a child to whom subsection (g) applies for the taxable year, the rules of subparagraphs (B) and (C) shall apply in lieu of the rule under subsection (g)(1).

''(B) MODIFICATIONS TO APPLICABLE RATE BRACKETS.—In determining the amount of tax imposed by this section for the taxable year on a child described in subparagraph (A), the income tax table otherwise applicable under this subsection to the child shall be applied with the following modifications:

''(i) 24-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 24 percent shall not be more than the sum of—

''(I) the earned taxable income of such child, plus

''(II) the minimum taxable income for the 24-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

''(ii) 35-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 35 percent shall not be more than the sum of—

''(I) the earned taxable income of such child, plus

''(II) the minimum taxable income for the 35-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

''(iii) 37-PERCENT BRACKET.—The maximum taxable income which is taxed at a rate below 37 percent shall not be more than the sum of—

''(I) the earned taxable income of such child, plus

''(II) the minimum taxable income for the 37-percent bracket in the table under paragraph (2)(E) (as adjusted under paragraph (3)) for the taxable year.

''(C) COORDINATION WITH CAPITAL GAINS RATES.—For purposes of applying section 1(h) (after the modifications under paragraph (5)(A))—

''(i) the maximum zero rate amount shall not be more than the sum of—

''(I) the earned taxable income of such child, plus

''(II) the amount in effect under paragraph (5)(B)(i)(IV) for the taxable year, and

''(ii) the maximum 15-percent rate amount shall not be more than the sum of—

''(I) the earned taxable income of such child, plus

''(II) the amount in effect under paragraph (5)(B)(ii)(IV) for the taxable year.

''(D) EARNED TAXABLE INCOME.—For purposes of this paragraph, the term 'earned taxable income' means, with respect to any child for any taxable year, the taxable income of such child reduced (but not below zero) by the net unearned income (as defined in subsection (g)(4)) of such child.

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

''(A) IN GENERAL.—Section 1(h)(1) shall be applied—

''(i) by substituting 'below the maximum zero rate amount' for 'which would (without regard to this paragraph) be taxed at a rate below 25 percent' in subparagraph (B)(i), and

''(ii) by substituting 'below the maximum 15-percent rate amount' for 'which would (without regard to this paragraph) be taxed at a rate below 39.6 percent' in subparagraph (C)(ii)(I).

''(B) MAXIMUM AMOUNTS DEFINED.—For purposes of applying section 1(h) with the modifications described in subparagraph (A)—

''(i) MAXIMUM ZERO RATE AMOUNT.—The maximum zero rate amount shall be—

''(I) in the case of a joint return or surviving spouse, $77,200,

''(II) in the case of an individual who is a head of 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 subclause (I), and

''(IV) in the case of an estate or trust, $2,600.

''(ii) MAXIMUM 15-PERCENT RATE AMOUNT.—The maximum 15-percent rate amount 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 clauses (i) and (ii) of subparagraph (B) shall be increased by an amount equal to—

''(i) such dollar amount, multiplied by

''(ii) the cost-of-living adjustment determined under subsection (f)(3) 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.

If any increase under this subparagraph is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

''(6) SECTION 15 NOT TO APPLY.—Section 15 shall not apply to any change in a rate of tax by reason of this subsection.''.

(b) DUE DILIGENCE TAX PREPARER REQUIREMENT WITH RESPECT TO HEAD OF HOUSEHOLD FILING STATUS.—Subsection (g) of section 6695 is amended to read as follows:

''(g) FAILURE TO BE DILIGENT IN DETERMINING ELIGIBILITY FOR CERTAIN TAX BENEFITS.—Any person who is a tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining—

''(1) eligibility to file as a head of household (as defined in section 2(b)) on the return, or

''(2) eligibility for, or the amount of, the credit allowable by section 24, 25A(a)(1), or 32,

shall pay a penalty of $500 for each such failure.''.

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

SEC. 11002. INFLATION ADJUSTMENTS BASED ON CHAINED CPI.

(a) IN GENERAL.—Subsection (f) of section 1 is amended by striking paragraph (3) and by inserting after paragraph (2) the following new paragraph:

''(3) 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 CPI for calendar year 2016, multiplied by the amount determined under subparagraph (B).

''(B) AMOUNT DETERMINED.—The amount determined under this clause is the amount obtained by dividing—

''(i) the C-CPI-U for calendar year 2016, by

''(ii) the CPI for calendar year 2016.

''(C) SPECIAL RULE FOR ADJUSTMENTS WITH A BASE YEAR AFTER 2016.—For purposes of any provision of this title which provides for the substitution of a year after 2016 for '2016' in subparagraph (A)(ii), subparagraph (A) shall be applied by substituting 'the C-CPI-U for calendar year 2016' for 'the CPI for calendar year 2016' and all that follows in clause (ii) thereof.''.

(b) C-CPI-U.—Subsection (f) of section 1 is amended by striking paragraph (7), by redesignating paragraph (6) as paragraph (7), and by inserting after paragraph (5) the following new paragraph:

''(6) 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.''.

(c) APPLICATION TO PERMANENT TAX TABLES.—

(1) IN GENERAL.—Section 1(f)(2)(A) is amended to read as follows:

''(A) except as provided in paragraph (8), by increasing the minimum and maximum dollar amounts for each bracket for which a tax is imposed under such table by the cost-of-living adjustment for such calendar year, determined—

''(i) except as provided in clause (ii), by substituting '1992' for '2016' in paragraph (3)(A)(ii), and

''(ii) in the case of adjustments to the dollar amounts at which the 36 percent rate bracket begins or at which the 39.6 percent rate bracket begins, by substituting '1993' for '2016' in paragraph (3)(A)(ii),''.

(2) CONFORMING AMENDMENTS.—Section 1(i) is amended—

(A) by striking ''for '1992' in subparagraph (B)'' in paragraph (1)(C) and inserting ''for '2016' in subparagraph (A)(ii)'', and

(B) by striking ''subsection (f)(3)(B) shall be applied by substituting '2012' for '1992' '' in paragraph (3)(C) and inserting ''subsection (f)(3)(A)(ii) shall be applied by substituting '2012' for '2016' ''.

(d) APPLICATION TO OTHER INTERNAL REVENUE CODE OF 1986 PROVISIONS.—

(1) The following sections are each amended by striking ''for 'calendar year 1992' in subparagraph (B)'' and inserting ''for 'calendar year 2016' in subparagraph (A)(ii)'':

(A) Section 23(h)(2).

(B) Paragraphs (1)(A)(ii) and (2)(A)(ii) of section 25A(h).

(C) Section 25B(b)(3)(B).

(D) Subsection (b)(2)(B)(ii)(II), and clauses (i) and (ii) of subsection (j)(1)(B), of section 32.

(E) Section 36B(f)(2)(B)(ii)(II).

(F) Section 41(e)(5)(C)(i).

(G) Subsections (e)(3)(D)(ii) and (h)(3)(H)(i)(II) of section 42.

(H) Section 45R(d)(3)(B)(ii).

(I) Section 55(d)(4)(A)(ii).

(J) Section 62(d)(3)(B).

(K) Section 63(c)(4)(B).

(L) Section 125(i)(2)(B).

(M) Section 135(b)(2)(B)(ii).

(N) Section 137(f)(2).

(O) Section 146(d)(2)(B).

(P) Section 147(c)(2)(H)(ii).

(Q) Section 151(d)(4)(B).

(R) Section 179(b)(6)(A)(ii).

(S) Subsections (b)(5)(C)(i)(II) and (g)(8)(B) of section 219.

(T) Section 220(g)(2).

(U) Section 221(f)(1)(B).

(V) Section 223(g)(1)(B).

(W) Section 408A(c)(3)(D)(ii).

(X) Section 430(c)(7)(D)(vii)(II).

(Y) Section 512(d)(2)(B).

(Z) Section 513(h)(2)(C)(ii).

(AA) Section 831(b)(2)(D)(ii).

(BB) Section 877A(a)(3)(B)(i)(II).

(CC) Section 2010(c)(3)(B)(ii).

(DD) Section 2032A(a)(3)(B).

(EE) Section 2503(b)(2)(B).

(FF) Section 4261(e)(4)(A)(ii).

(GG) Section 5000A(c)(3)(D)(ii).

(HH) Section 6323(i)(4)(B).

(II) Section 6334(g)(1)(B).

(JJ) Section 6601(j)(3)(B).

(KK) Section 6651(i)(1).

(LL) Section 6652(c)(7)(A).

(MM) Section 6695(h)(1).

(NN) Section 6698(e)(1).

(OO) Section 6699(e)(1).

(PP) Section 6721(f)(1).

(QQ) Section 6722(f)(1).

(RR) Section 7345(f)(2).

(SS) Section 7430(c)(1).

(TT) Section 9831(d)(2)(D)(ii)(II).

(2) Sections 41(e)(5)(C)(ii) and 68(b)(2)(B) are each amended—

(A) by striking ''1(f)(3)(B)'' and inserting ''1(f)(3)(A)(ii)'', and

(B) by striking ''1992'' and inserting ''2016''.

(3) Section 42(h)(6)(G) is amended—

(A) by striking ''for 'calendar year 1987' '' in clause (i)(II) and inserting ''for 'calendar year 2016' in subparagraph (A)(ii) thereof'', and

(B) by striking ''if the CPI for any calendar year'' and all that follows in clause (ii) and inserting ''if the C-CPI-U for any calendar year (as defined in section 1(f)(6)) exceeds the C-CPI-U for the preceding calendar year by more than 5 percent, the C-CPI-U for the base calendar year shall be increased such that such excess shall never be taken into account under clause (i). In the case of a base calendar year before 2017, the C-CPI-U for such year shall be determined by multiplying the CPI for such year by the amount determined under section 1(f)(3)(B).''.

(4) Section 59(j)(2)(B) is amended by striking ''for '1992' in subparagraph (B)'' and inserting ''for '2016' in subparagraph (A)(ii)''.

(5) Section 132(f)(6)(A)(ii) is amended by striking ''for 'calendar year 1992' '' and inserting ''for 'calendar year 2016' in subparagraph (A)(ii) thereof''.

(6) Section 162(o)(3) is amended by striking ''adjusted for changes in the Consumer Price Index (as defined in section 1(f)(5)) since 1991'' and inserting ''adjusted by increasing any such amount under the 1991 agreement by an amount equal to—

''(A) such amount, multiplied by

''(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 1990' for 'calendar year 2016' in subparagraph (A)(ii) thereof''.

(7) So much of clause (ii) of section 213(d)(10)(B) as precedes the last sentence is amended to read as follows:

''(ii) MEDICAL CARE COST ADJUSTMENT.—For purposes of clause (i), the medical care cost adjustment for any calendar year is the percentage (if any) by which—

''(I) the medical care component of the C-CPI-U (as defined in section 1(f)(6)) for August of the preceding calendar year, exceeds

''(II) such component of the CPI (as defined in section 1(f)(4)) for August of 1996, multiplied by the amount determined under section 1(f)(3)(B).''.

(8) Subparagraph (B) of section 280F(d)(7) is amended to read as follows:

''(B) AUTOMOBILE PRICE INFLATION ADJUSTMENT.—For purposes of this paragraph—

''(i) IN GENERAL.—The automobile price inflation adjustment for any calendar year is the percentage (if any) by which—

''(I) the C-CPI-U automobile component for October of the preceding calendar year, exceeds

''(II) the automobile component of the CPI (as defined in section 1(f)(4)) for October of 1987, multiplied by the amount determined under 1(f)(3)(B).

''(ii) C-CPI-U AUTOMOBILE COMPONENT.—The term 'C-CPI-U automobile component' means the automobile component of the Chained Consumer Price Index for All Urban Consumers (as described in section 1(f)(6)).''.

(9) Section 911(b)(2)(D)(ii)(II) is amended by striking ''for '1992' in subparagraph (B)'' and inserting ''for '2016' in subparagraph (A)(ii)''.

(10) Paragraph (2) of section 1274A(d) is amended to read as follows:

''(2) ADJUSTMENT FOR INFLATION.—In the case of any debt instrument arising out of a sale or exchange during any calendar year after 1989, each dollar amount contained in the preceding provisions of this section shall be increased by an amount equal to—

''(A) such amount, multiplied by

''(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 1988' for 'calendar year 2016' in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).''.

(11) Section 4161(b)(2)(C)(i)(II) is amended by striking ''for '1992' in subparagraph (B)'' and inserting ''for '2016' in subparagraph (A)(ii)''.

(12) Section 4980I(b)(3)(C)(v)(II) is amended by striking ''for '1992' in subparagraph (B)'' and inserting ''for '2016' in subparagraph (A)(ii)''.

(13) Section 6039F(d) is amended by striking ''subparagraph (B) thereof shall be applied by substituting '1995' for '1992''' and inserting ''subparagraph (A)(ii) thereof shall be applied by substituting '1995' for '2016'''.

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

''(5) ADJUSTMENT OF LIMIT FOR INFLATION.—In the case of any loan made during any calendar year after 1986, the dollar amount in paragraph (2) shall be increased by an amount equal to—

''(A) such amount, multiplied by

''(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 1985' for 'calendar year 2016' in subparagraph (A)(ii) thereof.

Any increase under the preceding sentence shall be rounded to the nearest multiple of $100 (or, if such increase is a multiple of $50, such increase shall be increased to the nearest multiple of $100).''.

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

PART II—DEDUCTION FOR QUALIFIED BUSINESS INCOME OF PASS-THRU ENTITIES

SEC. 11011. DEDUCTION FOR QUALIFIED BUSINESS INCOME.

(a) IN GENERAL.—Part VI of subchapter B of chapter 1 is amended by adding at the end the following new section:

''SEC. 199A. QUALIFIED BUSINESS INCOME.

''(a) IN GENERAL.—In the case of a taxpayer other than a corporation, there shall be allowed as a deduction for any taxable year an amount equal to the sum of—

''(1) the lesser of—

''(A) the combined qualified business income amount of the taxpayer, or

''(B) an amount equal to 20 percent of the excess (if any) of—

''(i) the taxable income of the taxpayer for the taxable year, over

''(ii) the sum of any net capital gain (as defined in section 1(h)), plus the aggregate amount of the qualified cooperative dividends, of the taxpayer for the taxable year, plus

''(2) the lesser of—

''(A) 20 percent of the aggregate amount of the qualified cooperative dividends of the taxpayer for the taxable year, or

''(B) taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

The amount determined under the preceding sentence shall not exceed the taxable income (reduced by the net capital gain (as so defined)) of the taxpayer for the taxable year.

''(b) COMBINED QUALIFIED BUSINESS INCOME AMOUNT.—For purposes of this section—

''(1) IN GENERAL.—The term 'combined qualified business income amount' means, with respect to any taxable year, an amount equal to—

''(A) the sum of the amounts determined under paragraph (2) for each qualified trade or business carried on by the taxpayer, plus

''(B) 20 percent of the aggregate amount of the qualified REIT dividends and qualified publicly traded partnership income of the taxpayer for the taxable year.

''(2) DETERMINATION OF DEDUCTIBLE AMOUNT FOR EACH TRADE OR BUSINESS.—The amount determined under this paragraph with respect to any qualified trade or business is the lesser of—

''(A) 20 percent of the taxpayer's qualified business income with respect to the qualified trade or business, or

''(B) the greater of—

''(i) 50 percent of the W–2 wages with respect to the qualified trade or business, or

''(ii) the sum of 25 percent of the W–2 wages with respect to the qualified trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property.

''(3) MODIFICATIONS TO LIMIT BASED ON TAXABLE INCOME.—

''(A) EXCEPTION FROM LIMIT.—In the case of any taxpayer whose taxable income for the taxable year does not exceed the threshold amount, paragraph (2) shall be applied without regard to subparagraph (B).

''(B) PHASE-IN OF LIMIT FOR CERTAIN TAXPAYERS.—

''(i) IN GENERAL.—If—

''(I) the taxable income of a taxpayer for any taxable year exceeds the threshold amount, but does not exceed the sum of the threshold amount plus $50,000 ($100,000 in the case of a joint return), and

''(II) the amount determined under paragraph (2)(B) (determined without regard to this subparagraph) with respect to any qualified trade or business carried on by the taxpayer is less than the amount determined under paragraph (2)(A) with respect such trade or business,

then paragraph (2) shall be applied with respect to such trade or business without regard to subparagraph (B) thereof and by reducing the amount determined under subparagraph (A) thereof by the amount determined under clause (ii).

''(ii) AMOUNT OF REDUCTION.—The amount determined under this subparagraph is the amount which bears the same ratio to the excess amount as—

''(I) the amount by which the taxpayer's taxable income for the taxable year exceeds the threshold amount, bears to

''(II) $50,000 ($100,000 in the case of a joint return).

''(iii) EXCESS AMOUNT.—For purposes of clause (ii), the excess amount is the excess of—

''(I) the amount determined under paragraph (2)(A) (determined without regard to this paragraph), over

''(II) the amount determined under paragraph (2)(B) (determined without regard to this paragraph).

''(4) WAGES, ETC.—

''(A) IN GENERAL.—The term 'W–2 wages' means, with respect to any person for any taxable year of such person, the amounts described in paragraphs (3) and (8) of section 6051(a) paid by such person with respect to employment of employees by such person during the calendar year ending during such taxable year.

''(B) LIMITATION TO WAGES ATTRIBUTABLE TO QUALIFIED BUSINESS INCOME.—Such term shall not include any amount which is not properly allocable to qualified business income for purposes of subsection (c)(1).

''(C) RETURN REQUIREMENT.—Such term shall not include any amount which is not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

''(5) ACQUISITIONS, DISPOSITIONS, AND SHORT TAXABLE YEARS.—The Secretary shall provide for the application of this subsection in cases of a short taxable year or where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the taxable year.

''(6) QUALIFIED PROPERTY.—For purposes of this section:

''(A) IN GENERAL.—The term 'qualified property' means, with respect to any qualified trade or business for a taxable year, tangible property of a character subject to the allowance for depreciation under section 167—

''(i) which is held by, and available for use in, the qualified trade or business at the close of the taxable year,

''(ii) which is used at any point during the taxable year in the production of qualified business income, and

''(iii) the depreciable period for which has not ended before the close of the taxable year.

''(B) DEPRECIABLE PERIOD.—The term 'depreciable period' means, with respect to qualified property of a taxpayer, the period beginning on the date the property was first placed in service by the taxpayer and ending on the later of—

''(i) the date that is 10 years after such date, or

''(ii) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (determined without regard to subsection (g) thereof).

''(c) QUALIFIED BUSINESS INCOME.—For purposes of this section—

''(1) IN GENERAL.—The term 'qualified business income' means, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. Such term shall not include any qualified REIT dividends, qualified cooperative dividends, or qualified publicly traded partnership income.

''(2) CARRYOVER OF LOSSES.—If the net amount of qualified income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year.

''(3) QUALIFIED ITEMS OF INCOME, GAIN, DEDUCTION, AND LOSS.—For purposes of this subsection—

''(A) IN GENERAL.—The term 'qualified items of income, gain, deduction, and loss' means items of income, gain, deduction, and loss to the extent such items are—

''(i) effectively connected with the conduct of a trade or business within the United States (within the meaning of section 864(c), determined by substituting 'qualified trade or business (within the meaning of section 199A)' for 'nonresident alien individual or a foreign corporation' or for 'a foreign corporation' each place it appears), and

''(ii) included or allowed in determining taxable income for the taxable year.

''(B) EXCEPTIONS.—The following investment items shall not be taken into account as a qualified item of income, gain, deduction, or loss:

''(i) Any item of short-term capital gain, short-term capital loss, long-term capital gain, or long-term capital loss.

''(ii) Any dividend, income equivalent to a dividend, or payment in lieu of dividends described in section 954(c)(1)(G).

''(iii) Any interest income other than interest income which is properly allocable to a trade or business.

''(iv) Any item of gain or loss described in subparagraph (C) or (D) of section 954(c)(1) (applied by substituting 'qualified trade or business' for 'controlled foreign corporation').

''(v) 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)).

''(vi) Any amount received from an annuity which is not received in connection with the trade or business.

''(vii) Any item of deduction or loss properly allocable to an amount described in any of the preceding clauses.

''(4) TREATMENT OF REASONABLE COMPENSATION AND GUARANTEED PAYMENTS.—Qualified business income shall not include—

''(A) reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business,

''(B) any guaranteed payment described in section 707(c) paid to a partner for services rendered with respect to the trade or business, and

''(C) to the extent provided in regulations, any payment described in section 707(a) to a partner for services rendered with respect to the trade or business.

''(d) QUALIFIED TRADE OR BUSINESS.—For purposes of this section—

''(1) IN GENERAL.—The term 'qualified trade or business' means any trade or business other than—

''(A) a specified service trade or business, or

''(B) the trade or business of performing services as an employee.

''(2) SPECIFIED SERVICE TRADE OR BUSINESS.—The term 'specified service trade or business' means any trade or business—

''(A) which is described in section 1202(e)(3)(A) (applied without regard to the words 'engineering, architecture,') or which would be so described if the term 'employees or owners' were substituted for 'employees' therein, or

''(B) which involves the performance of services that consist of investing and investment management, trading, or dealing in securities (as defined in section 475(c)(2)), partnership interests, or commodities (as defined in section 475(e)(2)).

''(3) EXCEPTION FOR SPECIFIED SERVICE BUSINESSES BASED ON TAXPAYER'S INCOME.—

''(A) IN GENERAL.—If, for any taxable year, the taxable income of any taxpayer is less than the sum of the threshold amount plus $50,000 ($100,000 in the case of a joint return), then—

''(i) any specified service trade or business of the taxpayer shall not fail to be treated as a qualified trade or business due to paragraph (1)(A), but

''(ii) only the applicable percentage of qualified items of income, gain, deduction, or loss, and the W–2 wages and the unadjusted basis immediately after acquisition of qualified property, of the taxpayer allocable to such specified service trade or business shall be taken into account in computing the qualified business income, W–2 wages, and the unadjusted basis immediately after acquisition of qualified property of the taxpayer for the taxable year for purposes of applying this section.

''(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the term 'applicable percentage' means, with respect to any taxable year, 100 percent reduced (not below zero) by the percentage equal to the ratio of—

''(i) the taxable income of the taxpayer for the taxable year in excess of the threshold amount, bears to

''(ii) $50,000 ($100,000 in the case of a joint return).

''(e) OTHER DEFINITIONS.—For purposes of this section—

''(1) TAXABLE INCOME.—Taxable income shall be computed without regard to the deduction allowable under this section.

''(2) THRESHOLD AMOUNT.—

''(A) IN GENERAL.—The term 'threshold amount' means $157,500 (200 percent of such amount in the case of a joint return).

''(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning after 2018, the dollar amount in subparagraph (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(f)(3) 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.

The amount of any increase under the preceding sentence shall be rounded as provided in section 1(f)(7).

''(3) QUALIFIED REIT DIVIDEND.—The term 'qualified REIT dividend' means any dividend from a real estate investment trust received during the taxable year which—

''(A) is not a capital gain dividend, as defined in section 857(b)(3), and

''(B) is not qualified dividend income, as defined in section 1(h)(11).

''(4) QUALIFIED COOPERATIVE DIVIDEND.—The term 'qualified cooperative dividend' means any patronage dividend (as defined in section 1388(a)), any per-unit retain allocation (as defined in section 1388(f)), and any qualified written notice of allocation (as defined in section 1388(c)), or any similar amount received from an organization described in subparagraph (B)(ii), which—

''(A) is includible in gross income, and

''(B) is received from—

''(i) an organization or corporation described in section 501(c)(12) or 1381(a), or

''(ii) an organization which is governed under this title by the rules applicable to cooperatives under this title before the enactment of subchapter T.

''(5) QUALIFIED PUBLICLY TRADED PARTNERSHIP INCOME.—The term 'qualified publicly traded partnership income' means, with respect to any qualified trade or business of a taxpayer, the sum of—

''(A) the net amount of such taxpayer's allocable share of each qualified item of income, gain, deduction, and loss (as defined in subsection (c)(3) and determined after the application of subsection (c)(4)) from a publicly traded partnership (as defined in section 7704(a)) which is not treated as a corporation under section 7704(c), plus

''(B) any gain recognized by such taxpayer upon disposition of its interest in such partnership to the extent such gain is treated as an amount realized from the sale or exchange of property other than a capital asset under section 751(a).

''(f) SPECIAL RULES.—

''(1) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.—

''(A) IN GENERAL.—In the case of a partnership or S corporation—

''(i) this section shall be applied at the partner or shareholder level,

''(ii) each partner or shareholder shall take into account such person's allocable share of each qualified item of income, gain, deduction, and loss, and

''(iii) each partner or shareholder shall be treated for purposes of subsection (b) as having W–2 wages and unadjusted basis immediately after acquisition of qualified property for the taxable year in an amount equal to such person's allocable share of the W–2 wages and the unadjusted basis immediately after acquisition of qualified property of the partnership or S corporation for the taxable year (as determined under regulations prescribed by the Secretary).

For purposes of clause (iii), a partner's or shareholder's allocable share of W–2 wages shall be determined in the same manner as the partner's or shareholder's allocable share of wage expenses. For purposes of such clause, partner's or shareholder's allocable share of the unadjusted basis immediately after acquisition of qualified property shall be determined in the same manner as the partner's or shareholder's allocable share of depreciation. For purposes of this subparagraph, in the case of an S corporation, an allocable share shall be the shareholder's pro rata share of an item.

''(B) APPLICATION TO TRUSTS AND ESTATES.—Rules similar to the rules under section 199(d)(1)(B)(i) (as in effect on December 1, 2017) for the apportionment of W–2 wages shall apply to the apportionment of W–2 wages and the apportionment of unadjusted basis immediately after acquisition of qualified property under this section.

''(C) TREATMENT OF TRADES OR BUSINESS IN PUERTO RICO.—

''(i) IN GENERAL.—In the case of any taxpayer with qualified business income from sources within the commonwealth of Puerto Rico, if all such income is taxable under section 1 for such taxable year, then for purposes of determining the qualified business income of such taxpayer for such taxable year, the term 'United States' shall include the Commonwealth of Puerto Rico.

''(ii) SPECIAL RULE FOR APPLYING LIMIT.—In the case of any taxpayer described in clause (i), the determination of W–2 wages of such taxpayer with respect to any qualified trade or business conducted in Puerto Rico shall be made without regard to any exclusion under section 3401(a)(8) for remuneration paid for services in Puerto Rico.

''(2) COORDINATION WITH MINIMUM TAX.—For purposes of determining alternative minimum taxable income under section 55, qualified business income shall be determined without regard to any adjustments under sections 56 through 59.

''(3) DEDUCTION LIMITED TO INCOME TAXES.—The deduction under subsection (a) shall only be allowed for purposes of this chapter.

''(4) REGULATIONS.—The Secretary shall prescribe such regulations as are necessary to carry out the purposes of this section, including regulations—

''(A) for requiring or restricting the allocation of items and wages under this section and such reporting requirements as the Secretary determines appropriate, and

''(B) for the application of this section in the case of tiered entities.

''(g) DEDUCTION ALLOWED TO SPECIFIED AGRICULTURAL OR HORTICULTURAL COOPERATIVES.—

''(1) IN GENERAL.—In the case of any taxable year of a specified agricultural or horticultural cooperative beginning after December 31, 2017, there shall be allowed a deduction in an amount equal to the lesser of—

''(A) 20 percent of the excess (if any) of—

''(i) the gross income of a specified agricultural or horticultural cooperative, over

''(ii) the qualified cooperative dividends (as defined in subsection (e)(4)) paid during the taxable year for the taxable year, or

''(B) the greater of—

''(i) 50 percent of the W–2 wages of the cooperative with respect to its trade or business, or

''(ii) the sum of 25 percent of the W–2 wages of the cooperative with respect to its trade or business, plus 2.5 percent of the unadjusted basis immediately after acquisition of all qualified property of the cooperative.

''(2) LIMITATION.—The amount determined under paragraph (1) shall not exceed the taxable income of the specified agricultural or horticultural for the taxable year.

''(3) SPECIFIED AGRICULTURAL OR HORTICULTURAL COOPERATIVE.—For purposes of this subsection, the term 'specified agricultural or horticultural cooperative' means an organization to which part I of subchapter T applies which is engaged in—

''(A) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product,

''(B) the marketing of agricultural or horticultural products which its patrons have so *manufactured, produced, grown, or extracted, or*

''(C) the provision of supplies, equipment, or services to farmers or to organizations described in subparagraph (A) or (B).

''(h) ANTI-ABUSE RULES.—The Secretary shall—

''(1) apply rules similar to the rules under section 179(d)(2) in order to prevent the manipulation of the depreciable period of qualified property using transactions between related parties, and

''(2) prescribe rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions.

''(i) TERMINATION.—This section shall not apply to taxable years beginning after December 31, 2025.''.

(b) TREATMENT OF DEDUCTION IN COMPUTING ADJUSTED GROSS AND TAXABLE INCOME.—

(1) DEDUCTION NOT ALLOWED IN COMPUTING ADJUSTED GROSS INCOME.—Section 62(a) is amended by adding at the end the following new sentence: ''The deduction allowed by section 199A shall not be treated as a deduction described in any of the preceding paragraphs of this subsection.''.

(2) DEDUCTION ALLOWED TO NONITEMIZERS.—Section 63(b) is amended by striking ''and'' at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting '', and'', and by adding at the end the following new paragraph:

''(3) the deduction provided in section 199A.''.

(3) DEDUCTION ALLOWED TO ITEMIZERS WITHOUT LIMITS ON ITEMIZED DEDUCTIONS.—Section 63(d) is amended by striking ''and'' at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting '', and'', and by adding at the end the following new paragraph:

''(3) the deduction provided in section 199A.''.

(4) CONFORMING AMENDMENT.—Section 3402(m)(1) is amended by inserting ''and the estimated deduction allowed under section 199A'' after ''chapter 1''.

(c) ACCURACY-RELATED PENALTY ON DETERMINATION OF APPLICABLE PERCENTAGE.—Section 6662(d)(1) is amended by inserting at the end the following new subparagraph:

''(C) SPECIAL RULE FOR TAXPAYERS CLAIMING SECTION 199A DEDUCTION.—In the case of any taxpayer who claims the deduction allowed under section 199A for the taxable year, subparagraph (A) shall be applied by substituting '5 percent' for '10 percent'.''.

(d) CONFORMING AMENDMENTS.—

(1) Section 172(d) is amended by adding at the end the following new paragraph:

''(8) QUALIFIED BUSINESS INCOME DEDUCTION.—The deduction under section 199A shall not be allowed.''.

(2) Section 246(b)(1) is amended by inserting ''199A,'' before ''243(a)(1)''.

(3) Section 613(a) is amended by inserting ''and without the deduction under section 199A'' after ''and without the deduction under section 199''.

(4) Section 613A(d)(1) is amended by redesignating subparagraphs (C), (D), and (E) as subparagraphs (D), (E), and (F), respectively, and by inserting after subparagraph (B), the following new subparagraph:

''(C) any deduction allowable under section 199A,''.

(5) Section 170(b)(2)(D) is amended by striking ''and'' in clause (iv), by striking the period at the end of clause (v), and by adding at the end the following new clause:

''(vi) section 199A(g).''.

(6) The table of sections for part VI of subchapter B of chapter 1 is amended by inserting at the end the following new item:

''Sec. 199A. Qualified business income.''.

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

SEC. 11012. LIMITATION ON LOSSES FOR TAXPAYERS OTHER THAN CORPORATIONS.

(a) IN GENERAL.—Section 461 is amended by adding at the end the following new subsection:

''(l) LIMITATION ON EXCESS BUSINESS LOSSES OF NONCORPORATE TAXPAYERS.—

''(1) LIMITATION.—In the case of taxable year of a taxpayer other than a corporation beginning after December 31, 2017, and before January 1, 2026—

''(A) subsection (j) (relating to limitation on excess farm losses of certain taxpayers) shall not apply, and

''(B) any excess business loss of the taxpayer for the taxable year shall not be allowed.

''(2) DISALLOWED LOSS CARRYOVER.—Any loss which is disallowed under paragraph (1) shall be treated as a net operating loss carryover to the following taxable year under section 172.

''(3) EXCESS BUSINESS LOSS.—For purposes of this subsection—

''(A) IN GENERAL.—The term 'excess business loss' means the excess (if any) of—

''(i) the aggregate deductions of the taxpayer for the taxable year which are attributable to trades or businesses of such taxpayer (determined without regard to whether or not such deductions are disallowed for such taxable year under paragraph (1)), over

''(ii) the sum of—

''(I) the aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such trades or businesses, plus

''(II) $250,000 (200 percent of such amount in the case of a joint return).

''(B) ADJUSTMENT FOR INFLATION.—In the case of any taxable year beginning after December 31, 2018, the $250,000 amount in subparagraph (A)(ii)(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(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2017' for '2016' in subparagraph (A)(ii) thereof.

If any amount as increased under the preceding sentence is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

''(4) APPLICATION OF SUBSECTION IN CASE OF PARTNERSHIPS AND S CORPORATIONS.—In the case of a partnership or S corporation—

''(A) this subsection shall be applied at the partner or shareholder level, and

''(B) each partner's or shareholder's allocable share of the items of income, gain, deduction, or loss of the partnership or S corporation for any taxable year from trades or businesses attributable to the partnership or S corporation shall be taken into account by the partner or shareholder in applying this subsection to the taxable year of such partner or shareholder with or within which the taxable year of the partnership or S corporation ends.

For purposes of this paragraph, in the case of an S corporation, an allocable share shall be the shareholder's pro rata share of an item.

''(5) ADDITIONAL REPORTING.—The Secretary shall prescribe such additional reporting requirements as the Secretary determines necessary to carry out the purposes of this subsection.

''(6) COORDINATION WITH SECTION 469.—This subsection shall be applied after the application of section 469.''.

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

PART III—TAX BENEFITS FOR FAMILIES AND INDIVIDUALS

SEC. 11021. INCREASE IN STANDARD DEDUCTION.

(a) IN GENERAL.—Subsection (c) of section 63 is amended by adding at the end the following new paragraph:

''(7) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

''(A) INCREASE IN STANDARD DEDUCTION.—Paragraph (2) shall be applied—

''(i) by substituting '$18,000' for '$4,400' in subparagraph (B), and

''(ii) by substituting '$12,000' for '$3,000' in subparagraph (C).

''(B) ADJUSTMENT FOR INFLATION.—

''(i) IN GENERAL.—Paragraph (4) shall not apply to the dollar amounts contained in paragraphs (2)(B) and (2)(C).

''(ii) ADJUSTMENT OF INCREASED AMOUNTS.—In the case of a taxable year beginning after 2018, the $18,000 and $12,000 amounts in subparagraph (A) shall each be increased by an amount equal to—

''(I) such dollar amount, multiplied by

''(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2017' for '2016' in subparagraph (A)(ii) thereof.

If any increase under this clause is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.''.

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

SEC. 11022. INCREASE IN AND MODIFICATION OF CHILD TAX CREDIT.

(a) IN GENERAL.—Section 24 is amended by adding at the end the following new subsection:

''(h) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—

''(1) IN GENERAL.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, this section shall be applied as provided in paragraphs (2) through (7).

''(2) CREDIT AMOUNT.—Subsection (a) shall be applied by substituting '$2,000' for '$1,000'.

''(3) LIMITATION.—In lieu of the amount determined under subsection (b)(2), the threshold amount shall be $400,000 in the case of a joint return ($200,000 in any other case).

''(4) PARTIAL CREDIT ALLOWED FOR CERTAIN OTHER DEPENDENTS.—

''(A) IN GENERAL.—The credit determined under subsection (a) (after the application of paragraph (2)) shall be increased by $500 for each dependent of the taxpayer (as defined in section 152) other than a qualifying child described in subsection (c).

''(B) EXCEPTION FOR CERTAIN NONCITIZENS.—Subparagraph (A) shall not apply with respect to any individual who would not be a dependent if subparagraph (A) of section 152(b)(3) were applied without regard to all that follows 'resident of the United States'.

''(C) CERTAIN QUALIFYING CHILDREN.—In the case of any qualifying child with respect to whom a credit is not allowed under this section by reason of paragraph (7), such child shall be treated as a dependent to whom subparagraph (A) applies.

''(5) MAXIMUM AMOUNT OF REFUNDABLE CREDIT.—

''(A) IN GENERAL.—The amount determined under subsection (d)(1)(A) with respect to any qualifying child shall not exceed $1,400, and such subsection shall be applied without regard to paragraph (4) of this subsection.

''(B) ADJUSTMENT FOR INFLATION.—In the case of a taxable year beginning after 2018, the $1,400 amount in subparagraph (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(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2017' for '2016' in subparagraph (A)(ii) thereof.

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

''(6) EARNED INCOME THRESHOLD FOR REFUNDABLE CREDIT.—Subsection (d)(1)(B)(i) shall be applied by substituting '$2,500' for '$3,000'.

''(7) SOCIAL SECURITY NUMBER REQUIRED.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the social security number of such child on the return of tax for the taxable year. For purposes of the preceding sentence, the term 'social security number' means a social security number issued to an individual by the Social Security Administration, but only if the social security number is issued—

''(A) 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, and

''(B) before the due date for such return.''.

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

SEC. 11023. INCREASED LIMITATION FOR CERTAIN CHARITABLE CONTRIBUTIONS.

(a) IN GENERAL.—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 beginning after December 31, 2017, and before January 1, 2026, 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) for any taxable year described in such clause, 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.—For each taxable year described in clause (i), and each taxable year to which any contribution under this subparagraph is carried over under clause (ii), subparagraph (A) shall be applied by reducing (but not below zero) the contribution limitation allowed for the taxable year under such subparagraph by the aggregate contributions allowed under this subparagraph for such taxable year, and subparagraph (B) shall be applied by treating any reference to subparagraph (A) as a reference to both subparagraph (A) and this subparagraph.''.

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

SEC. 11024. INCREASED CONTRIBUTIONS TO ABLE ACCOUNTS.

(a) INCREASE IN LIMITATION FOR CONTRIBUTIONS FROM COMPENSATION OF INDIVIDUALS WITH DISABILITIES.—

(1) IN GENERAL.—Section 529A(b)(2)(B) is amended to read as follows:

''(B) except in the case of contributions under subsection (c)(1)(C), if such contribution to an ABLE account would result in aggregate contributions from all contributors to the ABLE account for the taxable year exceeding the sum of—

''(i) the amount in effect under section 2503(b) for the calendar year in which the taxable year begins, plus

''(ii) in the case of any contribution by a designated beneficiary described in paragraph (7) before January 1, 2026, the lesser of—

''(I) compensation (as defined by section 219(f)(1)) includible in the designated beneficiary's gross income for the taxable year, or

''(II) an amount equal to the poverty line for a one-person household, as determined for the calendar year preceding the calendar year in which the taxable year begins.''.

(2) RESPONSIBILITY FOR CONTRIBUTION LIMITATION.—Paragraph (2) of section 529A(b) is amended by adding at the end the following: ''A designated beneficiary (or a person acting on behalf of such beneficiary) shall maintain adequate records for purposes of ensuring, and shall be responsible for ensuring, that the requirements of subparagraph (B)(ii) are met.''

(3) ELIGIBLE DESIGNATED BENEFICIARY.—Section 529A(b) is amended by adding at the end the following:

''(7) SPECIAL RULES RELATED TO CONTRIBUTION LIMIT.—For purposes of paragraph (2)(B)(ii)—

''(A) DESIGNATED BENEFICIARY.—A designated beneficiary described in this paragraph is an employee (including an employee within the meaning of section 401(c)) with respect to whom—

''(i) no contribution is made for the taxable year to a defined contribution plan (within the meaning of section 414(i)) with respect to which the requirements of section 401(a) or 403(a) are met,

''(ii) no contribution is made for the taxable year to an annuity contract described in section 403(b), and

''(iii) no contribution is made for the taxable year to an eligible deferred compensation plan described in section 457(b).

''(B) POVERTY LINE.—The term 'poverty line' has the meaning given such term by section 673 of the Community Services Block Grant Act (42 U.S.C. 9902).''.

(b) ALLOWANCE OF SAVER'S CREDIT FOR ABLE CONTRIBUTIONS BY ACCOUNT HOLDER.—Section 25B(d)(1) is amended by striking ''and'' at the end of subparagraph (B)(ii), by striking the period at the end of subparagraph (C) and inserting '', and'', and by inserting at the end the following:

''(D) the amount of contributions made before January 1, 2026, by such individual to the ABLE account (within the meaning of section 529A) of which such individual is the designated beneficiary.''.

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

SEC. 11025. ROLLOVERS TO ABLE PROGRAMS FROM 529 PROGRAMS.

(a) IN GENERAL.—Clause (i) of section 529(c)(3)(C) 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:

''(III) before January 1, 2026, 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)(i).''.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after the date of the enactment of this Act.

SEC. 11026. TREATMENT OF CERTAIN INDIVIDUALS PERFORMING SERVICES IN THE SINAI PENINSULA OF EGYPT.

(a) IN GENERAL.—For purposes of the following provisions of the Internal Revenue Code of 1986, with respect to the applicable period, a qualified hazardous duty area shall be treated in the same manner as if it were a combat zone (as determined under section 112 of such Code):

(1) Section 2(a)(3) (relating to special rule where deceased spouse was in missing status).

(2) Section 112 (relating to the exclusion of certain combat pay of members of the Armed Forces).

(3) Section 692 (relating to income taxes of members of Armed Forces on death).

(4) Section 2201 (relating to members of the Armed Forces dying in combat zone or by reason of combat-zone-incurred wounds, etc.).

(5) Section 3401(a)(1) (defining wages relating to combat pay for members of the Armed Forces).

(6) Section 4253(d) (relating to the taxation of phone service originating from a combat zone from members of the Armed Forces).

(7) Section 6013(f)(1) (relating to joint return where individual is in missing status).

(8) Section 7508 (relating to time for performing certain acts postponed by reason of service in combat zone).

(b) QUALIFIED HAZARDOUS DUTY AREA.—For purposes of this section, the term ''qualified hazardous duty area'' means the Sinai Peninsula of Egypt, if as of the date of the enactment of this section any member of the Armed Forces of the United States is entitled to special pay under section 310 of title 37, United States Code (relating to special pay; duty subject to hostile fire or imminent danger), for services performed in such location. Such term includes such location only during the period such entitlement is in effect.

(c) APPLICABLE PERIOD.—

(1) IN GENERAL.—Except as provided in paragraph (2), the applicable period is—

(A) the portion of the first taxable year ending after June 9, 2015, which begins on such date, and

(B) any subsequent taxable year beginning before January 1, 2026.

(2) WITHHOLDING.—In the case of subsection (a)(5), the applicable period is—

(A) the portion of the first taxable year ending after the date of the enactment of this Act which begins on such date, and

(B) any subsequent taxable year beginning before January 1, 2026.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the provisions of this section shall take effect on June 9, 2015.

(2) WITHHOLDING.—Subsection (a)(5) shall apply to remuneration paid after the date of the enactment of this Act.

SEC. 11027. TEMPORARY REDUCTION IN MEDICAL EXPENSE DEDUCTION FLOOR.

(a) IN GENERAL.—Subsection (f) of section 213 is amended to read as follows:

''(f) SPECIAL RULES FOR 2013 THROUGH 2018.—In the case of any taxable year—

''(1) beginning after December 31, 2012, and ending before January 1, 2017, in the case of a taxpayer if such taxpayer or such taxpayer's spouse has attained age 65 before the close of such taxable year, and

''(2) beginning after December 31, 2016, and ending before January 1, 2019, in the case of any taxpayer,

subsection (a) shall be applied with respect to a taxpayer by substituting '7.5 percent' for '10 percent'.''.

(b) MINIMUM TAX PREFERENCE NOT TO APPLY.—Section 56(b)(1)(B) is amended by adding at the end the following new sentence:''This subparagraph shall not apply to taxable years beginning after December 31, 2016, and ending before January 1, 2019''.

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2016.

SEC. 11028. RELIEF FOR 2016 DISASTER AREAS.

(a) IN GENERAL.—For purposes of this section, the term ''2016 disaster area'' means any area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016.

(b) SPECIAL RULES FOR USE OF RETIREMENT FUNDS WITH RESPECT TO AREAS DAMAGED BY 2016 DISASTERS.—

(1) TAX-FAVORED WITHDRAWALS FROM RETIREMENT PLANS.—

(A) IN GENERAL.—Section 72(t) of the Internal Revenue Code of 1986 shall not apply to any qualified 2016 disaster distribution.

(B) AGGREGATE DOLLAR LIMITATION.—

(i) IN GENERAL.—For purposes of this subsection, the aggregate amount of distributions received by an individual which may be treated as qualified 2016 disaster distributions for any taxable year shall not exceed the excess (if any) of—

(I) $100,000, over

(II) the aggregate amounts treated as qualified 2016 disaster distributions received by such individual for all prior taxable years.

(ii) TREATMENT OF PLAN DISTRIBUTIONS.—If a distribution to an individual would (without regard to clause (i)) be a qualified 2016 disaster distribution, a plan shall not be treated as violating any requirement of this title merely because the plan treats such distribution as a qualified 2016 disaster distribution, unless the aggregate amount of such distributions from all plans maintained by the employer (and any member of any controlled group which includes the employer) to such individual exceeds $100,000.

(iii) CONTROLLED GROUP.—For purposes of clause (ii), the term ''controlled group'' means any group treated as a single employer under subsection (b), (c), (m), or (o) of section 414 of the Internal Revenue Code of 1986.

(C) AMOUNT DISTRIBUTED MAY BE REPAID.—

(i) IN GENERAL.—Any individual who receives a qualified 2016 disaster distribution may, at any time during the 3-year period beginning on the day after the date on which such distribution was received, make one or more contributions in an aggregate amount not to exceed the amount of such distribution to an eligible retirement plan of which such individual is a beneficiary and to which a rollover contribution of such distribution could be made under section 402(c), 403(a)(4), 403(b)(8), 408(d)(3), or 457(e)(16) of the Internal Revenue Code of 1986, as the case may be.

(ii) TREATMENT OF REPAYMENTS OF DISTRIBUTIONS FROM ELIGIBLE RETIREMENT PLANS OTHER THAN IRAS.—For purposes of the Internal Revenue Code of 1986, if a contribution is made pursuant to clause (i) with respect to a qualified 2016 disaster distribution from an eligible retirement plan other than an individual retirement plan, then the taxpayer shall, to the extent of the amount of the contribution, be treated as having received the qualified 2016 disaster distribution in an eligible rollover distribution (as defined in section 402(c)(4) of the Internal Revenue Code of 1986) and as having transferred the amount to the eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution.

(iii) TREATMENT OF REPAYMENTS FOR DISTRIBUTIONS FROM IRAS.—For purposes of the Internal Revenue Code of 1986, if a contribution is made pursuant to clause (i) with respect to a qualified 2016 disaster distribution from an individual retirement plan (as defined by section 7701(a)(37) of the Internal Revenue Code of 1986), then, to the extent of the amount of the contribution, the qualified 2016 disaster distribution shall be treated as a distribution described in section 408(d)(3) of such Code and as having been transferred to the eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution.

(D) DEFINITIONS.—For purposes of this paragraph—

(i) QUALIFIED 2016 DISASTER DISTRIBUTION.—Except as provided in subparagraph (B), the term ''qualified 2016 disaster distribution'' means any distribution from an eligible retirement plan made on or after January 1, 2016, and before January 1, 2018, to an individual whose principal place of abode at any time during calendar year 2016 was located in a disaster area described in subsection (a) and who has sustained an economic loss by reason of the events giving rise to the Presidential declaration described in subsection (a) which was applicable to such area.

(ii) ELIGIBLE RETIREMENT PLAN.—The term ''eligible retirement plan'' shall have the meaning given such term by section 402(c)(8)(B) of the Internal Revenue Code of 1986.

(E) INCOME INCLUSION SPREAD OVER 3-YEAR PERIOD.—

(i) IN GENERAL.—In the case of any qualified 2016 disaster distribution, unless the taxpayer elects not to have this subparagraph apply for any taxable year, any amount required to be included in gross income for such taxable year shall be so included ratably over the 3-taxable-year period beginning with such taxable year.

(ii) SPECIAL RULE.—For purposes of clause (i), rules similar to the rules of subparagraph (E) of section 408A(d)(3) of the Internal Revenue Code of 1986 shall apply.

(F) SPECIAL RULES.—

(i) EXEMPTION OF DISTRIBUTIONS FROM TRUSTEE TO TRUSTEE TRANSFER AND WITHHOLDING RULES.—For purposes of sections 401(a)(31), 402(f), and 3405 of the Internal Revenue Code of 1986, qualified 2016 disaster distribution shall not be treated as eligible rollover distributions.

(ii) QUALIFIED 2016 DISASTER DISTRIBUTIONS TREATED AS MEETING PLAN DISTRIBUTION REQUIREMENTS.—For purposes of the Internal Revenue Code of 1986, a qualified 2016 disaster distribution shall be treated as meeting the requirements of sections 401(k)(2)(B)(i), 403(b)(7)(A)(ii), 403(b)(11), and 457(d)(1)(A) of the Internal Revenue Code of 1986.

(2) PROVISIONS RELATING TO PLAN AMENDMENTS.—

(A) IN GENERAL.—If this paragraph applies to any amendment to any plan or annuity contract, such plan or contract shall be treated as being operated in accordance with the terms of the plan during the period described in subparagraph (B)(ii)(I).

(B) AMENDMENTS TO WHICH SUBSECTION APPLIES.—

(i) IN GENERAL.—This paragraph shall apply to any amendment to any plan or annuity contract which is made—

(I) pursuant to any provision of this section, or pursuant to any regulation under any provision of this section, and

(II) on or before the last day of the first plan year beginning on or after January 1, 2018, or such later date as the Secretary prescribes.

In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), subclause (II) shall be applied by substituting the date which is 2 years after the date otherwise applied under subclause (II).

(ii) CONDITIONS.—This paragraph shall not apply to any amendment to a plan or contract unless such amendment applies retroactively for such period, and shall not apply to any such amendment unless the plan or contract is operated as if such amendment were in effect during the period—

(I) beginning on the date that this section or the regulation described in clause (i)(I) takes effect (or in the case of a plan or contract amendment not required by this section or such regulation, the effective date specified by the plan), and

(II) ending on the date described in clause (i)(II) (or, if earlier, the date the plan or contract amendment is adopted).

(c) SPECIAL RULES FOR PERSONAL CASUALTY LOSSES RELATED TO 2016 MAJOR DISASTER.—

(1) IN GENERAL.—If an individual has a net disaster loss for any taxable year beginning after December 31, 2015, and before January 1, 2018—

(A) the amount determined under section 165(h)(2)(A)(ii) of the Internal Revenue Code of 1986 shall be equal to the sum of—

(i) such net disaster loss, and

(ii) so much of the excess referred to in the matter preceding clause (i) of section 165(h)(2)(A) of such Code (reduced by the amount in clause (i) of this subparagraph) as exceeds 10 percent of the adjusted gross income of the individual,

(B) section 165(h)(1) of such Code shall be applied by substituting ''$500'' for ''$500 ($100 for taxable years beginning after December 31, 2009)'',

(C) the standard deduction determined under section 63(c) of such Code shall be increased by the net disaster loss, and

(D) section 56(b)(1)(E) of such Code shall not apply to so much of the standard deduction as is attributable to the increase under subparagraph (C) of this paragraph.

(2) NET DISASTER LOSS.—For purposes of this subsection, the term ''net disaster loss'' means the excess of qualified disaster-related personal casualty losses over personal casualty gains (as defined in section 165(h)(3)(A) of the Internal Revenue Code of 1986).

(3) QUALIFIED DISASTER-RELATED PERSONAL CASUALTY LOSSES.—For purposes of this paragraph, the term ''qualified disaster-related personal casualty losses'' means losses described in section 165(c)(3) of the Internal Revenue Code of 1986 which arise in a disaster area described in subsection (a) on or after January 1, 2016, and which are attributable to the events giving rise to the Presidential declaration described in subsection (a) which was applicable to such area.

PART IV—EDUCATION

SEC. 11031. TREATMENT OF STUDENT LOANS DISCHARGED ON ACCOUNT OF DEATH OR DISABILITY.

(a) IN GENERAL.—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 for such taxable year by reasons of the discharge (in whole or in part) of any loan described in subparagraph (B) after December 31, 2017, and before January 1, 2026, 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) EFFECTIVE DATE.—The amendment made by this section shall apply to discharges of indebtedness after December 31, 2017.

SEC. 11032. 529 ACCOUNT FUNDING FOR ELEMENTARY AND SECONDARY EDUCATION.

(a) IN GENERAL.—

(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—

''(A) expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school, and

''(B) expenses for—

''(i) curriculum and curricular materials,

''(ii) books or other instructional materials,

''(iii) online educational materials,

''(iv) tuition for tutoring or educational classes outside of the home (but only if the tutor or instructor is not related (within the meaning of section 152(d)(2)) to the student),

''(v) dual enrollment in an institution of higher education, and

''(vi) educational therapies for students with disabilities,

in connection with a homeschool (whether treated as a homeschool or a private school for purposes of applicable State law).''.

(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 described in subsection (c)(7) incurred during the taxable year.''.

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

PART V—DEDUCTIONS AND EXCLUSIONS

SEC. 11041. SUSPENSION OF DEDUCTION FOR PERSONAL EXEMPTIONS.

(a) IN GENERAL.—Subsection (d) of section 151 is amended—

(1) by striking ''In the case of'' in paragraph (4) and inserting ''Except as provided in paragraph (5), in the case of'', and

(2) by adding at the end the following new paragraph:

''(5) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026—

''(A) EXEMPTION AMOUNT.—The term 'exemption amount' means zero.

''(B) REFERENCES.—For purposes of any other provision of this title, the reduction of the exemption amount to zero under subparagraph (A) shall not be taken into account in determining whether a deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction, under this section.''.

(b) APPLICATION TO ESTATES AND TRUSTS.—Section 642(b)(2)(C) is amended by adding at the end the following new clause:

''(iii) YEARS WHEN PERSONAL EXEMPTION AMOUNT IS ZERO.—

''(I) IN GENERAL.—In the case of any taxable year in which the exemption amount under section 151(d) is zero, clause (i) shall be applied by substituting '$4,150' for 'the exemption amount under section 151(d)'.

''(II) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2018, the $4,150 amount in subparagraph (A) shall be increased in the same manner as provided in section 6334(d)(4)(C).''.

(c) MODIFICATION OF WAGE WITHHOLDING RULES.—

(1) IN GENERAL.—Section 3402(a)(2) is amended by striking ''means the amount'' and all that follows and inserting ''means the amount by which the wages exceed the taxpayer's withholding allowance, prorated to the payroll period.''.

(2) CONFORMING AMENDMENTS.—

(A) Section 3401 is amended by striking subsection (e).

(B) Paragraphs (1) and (2) of section 3402(f) are amended to read as follows:

''(1) IN GENERAL.—Under rules determined by the Secretary, an employee receiving wages shall on any day be entitled to a withholding allowance determined based on—

''(A) whether the employee is an individual for whom a deduction is allowable with respect to another taxpayer under section 151;

''(B) if the employee is married, whether the employee's spouse is entitled to an allowance, or would be so entitled if such spouse were an employee receiving wages, under subparagraph (A) or (D), but only if such spouse does not have in effect a withholding allowance certificate claiming such allowance;

''(C) the number of individuals with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable a credit under section 24(a) for the taxable year under subtitle A in respect of which amounts deducted and withheld under this chapter in the calendar year in which such day falls are allowed as a credit;

''(D) any additional amounts to which the employee elects to take into account under subsection (m), but only if the employee's spouse does not have in effect a withholding allowance certificate making such an election;

''(E) the standard deduction allowable to such employee (one-half of such standard deduction in the case of an employee who is married (as determined under section 7703) and whose spouse is an employee receiving wages subject to withholding); and

''(F) whether the employee has withholding allowance certificates in effect with respect to more than 1 employer.

''(2) ALLOWANCE CERTIFICATES.—

''(A) ON COMMENCEMENT OF EMPLOYMENT.—On or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding allowance certificate relating to the withholding allowance claimed by the employee, which shall in no event exceed the amount to which the employee is entitled.

''(B) CHANGE OF STATUS.—If, on any day during the calendar year, an employee's withholding allowance is in excess of the withholding allowance to which the employee would be entitled had the employee submitted a true and accurate withholding allowance certificate to the employer on that day, the employee shall within 10 days thereafter furnish the employer with a new withholding allowance certificate. If, on any day during the calendar year, an employee's withholding allowance is greater than the withholding allowance claimed, the employee may furnish the employer with a new withholding allowance certificate relating to the withholding allowance to which the employee is so entitled, which shall in no event exceed the amount to which the employee is entitled on such day.

''(C) CHANGE OF STATUS WHICH AFFECTS NEXT CALENDAR YEAR.—If on any day during the calendar year the withholding allowance to which the employee will be, or may reasonably be expected to be, entitled at the beginning of the employee's next taxable year under subtitle A is different from the allowance to which the employee is entitled on such day, the employee shall, in such cases and at such times as the Secretary shall by regulations prescribe, furnish the employer with a withholding allowance certificate relating to the withholding allowance which the employee claims with respect to such next taxable year, which shall in no event exceed the withholding allowance to which the employee will be, or may reasonably be expected to be, so entitled.''.

(C) Subsections (b)(1), (b)(2), (f)(3), (f)(4), (f)(5), (f)(7) (including the heading thereof), (g)(4), (l)(1), (l)(2), and (n) of section 3402 are each amended by striking ''exemption'' each place it appears and inserting ''allowance''.

(D) The heading of section 3402(f) is amended by striking ''EXEMPTIONS'' and inserting ''ALLOWANCE''.

(E) Section 3402(m) is amended by striking ''additional withholding allowances or additional reductions in withholding under this subsection. In determining the number of additional withholding allowances'' and inserting ''an additional withholding allowance or additional reductions in withholding under this subsection. In determining the additional withholding allowance''.

(F) Paragraphs (3) and (4) of section 3405(a) (and the heading for such paragraph (4)) are each amended by striking ''exemption'' each place it appears and inserting ''allowance''.

(G) Section 3405(a)(4) is amended by striking ''shall be determined'' and all that follows through ''3 withholding exemptions'' and inserting ''shall be determined under rules prescribed by the Secretary''.

(d) EXCEPTION FOR DETERMINING PROPERTY EXEMPT FROM LEVY.—Section 6334(d) is amended by adding at the end the following new paragraph:

''(4) YEARS WHEN PERSONAL EXEMPTION AMOUNT IS ZERO.—

''(A) IN GENERAL.—In the case of any taxable year in which the exemption amount under section 151(d) is zero, paragraph (2) shall not apply and for purposes of paragraph (1) the term 'exempt amount' means an amount equal to—

''(i) the sum of the amount determined under subparagraph (B) and the standard deduction, divided by

''(ii) 52.

''(B) AMOUNT DETERMINED.—For purposes of subparagraph (A), the amount determined under this subparagraph is $4,150 multiplied by the number of the taxpayer's dependents for the taxable year in which the levy occurs.

''(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2018, the $4,150 amount in subparagraph (B) shall be increased by an amount equal to—

''(i) such dollar amount, multiplied by

''(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2017' for '2016' in subparagraph (A)(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.

''(D) 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.''.

(e) PERSONS REQUIRED TO MAKE RETURNS OF INCOME.—Section 6012 is amended by adding at the end the following new subsection:

''(f) SPECIAL RULE FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of a taxable year beginning after December 31, 2017, and before January 1, 2026, subsection (a)(1) shall not apply, and every individual who has gross income for the taxable year shall be required to make returns with respect to income taxes under subtitle A, except that a return shall not be required of—

''(1) 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

''(2) an individual entitled to make a joint return if—

''(A) 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,

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

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

''(D) neither such individual nor such individual's spouse is an individual described in section 63(c)(5) who has income (other than earned income) in excess of the amount in effect under section 63(c)(5)(A).''.

(f) EFFECTIVE DATE.—

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

(2) WAGE WITHHOLDING.—The Secretary of the Treasury may administer section 3402 for taxable years beginning before January 1, 2019, without regard to the amendments made by subsections (a) and (c).

SEC. 11042. LIMITATION ON DEDUCTION FOR STATE AND LOCAL, ETC. TAXES.

(a) IN GENERAL.—Subsection (b) of section 164 is amended by adding at the end the following new paragraph:

''(6) LIMITATION ON INDIVIDUAL DEDUCTIONS FOR TAXABLE YEARS 2018 THROUGH 2025.—In the case of an individual and a taxable year beginning after December 31, 2017, and before January 1, 2026—

''(A) foreign real property taxes shall not be taken into account under subsection (a)(1), and

''(B) the aggregate amount of taxes taken into account under paragraphs (1), (2), and (3) of subsection (a) and paragraph (5) of this subsection for any taxable year shall not exceed $10,000 ($5,000 in the case of a married individual filing a separate return).

The preceding sentence shall not apply to any foreign taxes described in subsection (a)(3) or to any taxes described in paragraph (1) and (2) of subsection (a) which are paid or accrued in carrying on a trade or business or an activity described in section 212. For purposes of subparagraph (B), an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, shall be treated as paid on the last day of the taxable year for which such tax is so imposed.''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2016.

SEC. 11043. LIMITATION ON DEDUCTION FOR QUALIFIED RESIDENCE INTEREST.

(a) IN GENERAL.—Section 163(h)(3) is amended by adding at the end the following new subparagraph:

''(F) SPECIAL RULES FOR TAXABLE YEARS 2018 THROUGH 2025.—

''(i) IN GENERAL.—In the case of taxable years beginning after December 31, 2017, and before January 1, 2026—

''(I) DISALLOWANCE OF HOME EQUITY INDEBTEDNESS INTEREST.—Subparagraph (A)(ii) shall not apply.

''(II) LIMITATION ON ACQUISITION INDEBTEDNESS.—Subparagraph (B)(ii) shall be applied by substituting '$750,000 ($375,000' for '$1,000,000 ($500,000'.

''(III) TREATMENT OF INDEBTEDNESS INCURRED ON OR BEFORE DECEMBER 15, 2017.—Subclause (II) shall not apply to any indebtedness incurred on or before December 15, 2017, and, in applying such subclause to any indebtedness incurred after such date, the limitation under such subclause shall be reduced (but not below zero) by the amount of any indebtedness incurred on or before December 15, 2017, which is treated as acquisition indebtedness for purposes of this subsection for the taxable year.

''(IV) BINDING CONTRACT EXCEPTION.—In the case of a taxpayer who enters into a written binding contract before December 15, 2017, to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, subclause (III) shall be applied by substituting 'April 1, 2018' for 'December 15, 2017'.

''(ii) TREATMENT OF LIMITATION IN TAXABLE YEARS AFTER DECEMBER 31, 2025.—In the case of taxable years beginning after December 31, 2025, the limitation under subparagraph (B)(ii) shall be applied to the aggregate amount of indebtedness of the taxpayer described in subparagraph (B)(i) without regard to the taxable year in which the indebtedness was incurred.

''(iii) TREATMENT OF REFINANCINGS OF INDEBTEDNESS.—

''(I) IN GENERAL.—In the case of any indebtedness which is incurred to refinance indebtedness, such refinanced indebtedness shall be treated for purposes of clause (i)(III) as incurred on the date that the original indebtedness was incurred to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

''(II) LIMITATION ON PERIOD OF REFINANCING.—Subclause (I) shall not apply to any indebtedness after the expiration of the term of the original indebtedness or, 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) COORDINATION WITH EXCLUSION OF INCOME FROM DISCHARGE OF INDEBTEDNESS.—Section 108(h)(2) shall be applied without regard to this subparagraph.''.

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

SEC. 11044. MODIFICATION OF DEDUCTION FOR PERSONAL CASUALTY LOSSES.

(a) IN GENERAL.—Subsection (h) of section 165 is amended by adding at the end the following new paragraph:

''(5) LIMITATION FOR TAXABLE YEARS 2018 THROUGH 2025.—

''(A) IN GENERAL.—In the case of an individual, except as provided in subparagraph (B), any personal casualty loss which (but for this paragraph) would be deductible in a taxable year beginning after December 31, 2017, and before January 1, 2026, shall be allowed as a deduction under subsection (a) only to the extent it is attributable to a Federally declared disaster (as defined in subsection (i)(5)).

''(B) EXCEPTION RELATED TO PERSONAL CASUALTY GAINS.—If a taxpayer has personal casualty gains for any taxable year to which subparagraph (A) applies—

''(i) subparagraph (A) shall not apply to the portion of the personal casualty loss not attributable to a Federally declared disaster (as so defined) to the extent such loss does not exceed such gains, and

''(ii) in applying paragraph (2) for purposes of subparagraph (A) to the portion of personal casualty loss which is so attributable to such a disaster, the amount of personal casualty gains taken into account under paragraph (2)(A) shall be reduced by the portion of such gains taken into account under clause (i).''.

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

SEC. 11045. SUSPENSION OF MISCELLANEOUS ITEMIZED DEDUCTIONS.

(a) IN GENERAL.—Section 67 is amended by adding at the end the following new subsection:

''(g) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.—Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026.''.

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

SEC. 11046. SUSPENSION OF OVERALL LIMITATION ON ITEMIZED DEDUCTIONS.

(a) IN GENERAL.—Section 68 is amended by adding at the end the following new subsection:

''(f) SECTION NOT TO APPLY.—This section shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.''.

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

SEC. 11047. SUSPENSION OF EXCLUSION FOR QUALIFIED BICYCLE COMMUTING REIMBURSEMENT.

(a) IN GENERAL.—Section 132(f) is amended by adding at the end the following new paragraph:

''(8) SUSPENSION OF QUALIFIED BICYCLE COMMUTING REIMBURSEMENT EXCLUSION.—Paragraph (1)(D) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.''.

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

SEC. 11048. SUSPENSION OF EXCLUSION FOR QUALIFIED MOVING EXPENSE REIMBURSEMENT.

(a) IN GENERAL.—Section 132(g) is amended—

(1) by striking ''For purposes of this section, the term'' and inserting ''For purposes of this section—

''(1) IN GENERAL.—The term'', and

(2) by adding at the end the following new paragraph:

''(2) SUSPENSION FOR TAXABLE YEARS 2018 THROUGH 2025.—Except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station, subsection (a)(6) shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.''.

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

SEC. 11049. SUSPENSION OF DEDUCTION FOR MOVING EXPENSES.

(a) IN GENERAL.—Section 217 is amended by adding at the end the following new subsection:

''(k) SUSPENSION OF DEDUCTION FOR TAXABLE YEARS 2018 THROUGH 2025.—Except in the case of an individual to whom subsection (g) applies, this section shall not apply to any taxable year beginning after December 31, 2017, and before January 1, 2026.''.

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

SEC. 11050. 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, in the case of taxable years beginning after December 31, 2017, and before January 1, 2026, 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 amendment made by this section shall apply to taxable years beginning after December 31, 2017.

SEC. 11051. 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)''.

(C) Section 6724(d)(3) is amended by striking subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(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 152(d)(5) is amended to read as follows:

''(5) SPECIAL RULES FOR SUPPORT.—

''(A) IN GENERAL.—For purposes of this subsection—

''(i) payments to a spouse of alimony or separate maintenance payments shall not be treated as a payment by the payor spouse for the support of any dependent, and

''(ii) in the case of the remarriage of a parent, support of a child received from the parent's spouse shall be treated as received from the parent.

''(B) ALIMONY OR SEPARATE MAINTENANCE PAYMENT.—For purposes of subparagraph (A), the term 'alimony or separate maintenance payment' means any payment in cash if—

''(i) such payment is received by (or on behalf of) a spouse under a divorce or separation instrument (as defined in section 121(d)(3)(C)),

''(ii) in the case of an individual legally separated from the individual's spouse under a decree of divorce or of separate maintenance, the payee spouse and the payor spouse are not members of the same household at the time such payment is made, and

''(iii) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.''.

(C) Section 219(f)(1) is amended by striking the third sentence.

(D) 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)''.

(E) 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)''.

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

(G) 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)''.

(4) ADDITIONAL CONFORMING AMENDMENTS.—Section 7701(a)(17) is amended—

(A) by striking ''sections 682 and 2516'' and inserting ''section 2516'', and

(B) by striking ''such sections'' each place it appears and inserting ''such section''.

(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, 2018, 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.

PART VI—INCREASE IN ESTATE AND GIFT TAX EXEMPTION

SEC. 11061. INCREASE IN ESTATE AND GIFT TAX EXEMPTION.

(a) IN GENERAL.—Section 2010(c)(3) is amended by adding at the end the following new subparagraph:

''(C) INCREASE IN BASIC EXCLUSION AMOUNT.—In the case of estates of decedents dying or gifts made after December 31, 2017, and before January 1, 2026, subparagraph (A) shall be applied by substituting '$10,000,000' for '$5,000,000'.''.

(b) CONFORMING AMENDMENT.—Subsection (g) of section 2001 is amended to read as follows:

''(g) MODIFICATIONS TO TAX PAYABLE.—

''(1) MODIFICATIONS TO GIFT TAX PAYABLE TO REFLECT DIFFERENT TAX RATES.—For purposes of applying subsection (b)(2) with respect to 1 or more gifts, the rates of tax under subsection (c) in effect at the decedent's death shall, in lieu of the rates of tax in effect at the time of such gifts, be used both to compute—

''(A) the tax imposed by chapter 12 with respect to such gifts, and

''(B) the credit allowed against such tax under section 2505, including in computing—

''(i) the applicable credit amount under section 2505(a)(1), and

''(ii) the sum of the amounts allowed as a credit for all preceding periods under section 2505(a)(2).

''(2) MODIFICATIONS TO ESTATE TAX PAYABLE TO REFLECT DIFFERENT BASIC EXCLUSION AMOUNTS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this section with respect to any difference between—

''(A) the basic exclusion amount under section 2010(c)(3) applicable at the time of the decedent's death, and

''(B) the basic exclusion amount under such section applicable with respect to any gifts made by the decedent.''.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying and gifts made after December 31, 2017.

PART VII—EXTENSION OF TIME LIMIT FOR CONTESTING IRS LEVY

SEC. 11071. EXTENSION OF TIME LIMIT FOR CONTESTING IRS LEVY.

(a) EXTENSION OF TIME FOR RETURN OF PROPERTY SUBJECT TO LEVY.—Subsection (b) of section 6343 is amended by striking ''9 months'' and inserting ''2 years''.

(b) PERIOD OF LIMITATION ON SUITS.—Subsection (c) of section 6532 is amended—

(1) by striking ''9 months'' in paragraph (1) and inserting ''2 years'', and

(2) by striking ''9-month'' in paragraph (2) and inserting ''2-year''.

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

(1) levies made after the date of the enactment of this Act, and

(2) levies made on or before such date if the 9-month period has not expired under section 6343(b) of the Internal Revenue Code of 1986 (without regard to this section) as of such date.

PART VIII—INDIVIDUAL MANDATE

SEC. 11081. ELIMINATION OF SHARED RESPONSIBILITY PAYMENT FOR INDIVIDUALS FAILING TO MAINTAIN MINIMUM ESSENTIAL COVERAGE.

(a) IN GENERAL.—Section 5000A(c) is amended—

(1) in paragraph (2)(B)(iii), by striking ''2.5 percent'' and inserting ''Zero percent'', and

(2) in paragraph (3)—

(A) by striking ''$695'' in subparagraph (A) and inserting ''$0'', and

(B) by striking subparagraph (D).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to months beginning after December 31, 2018.

Subtitle B—Alternative Minimum Tax

SEC. 12001. REPEAL OF TAX FOR CORPORATIONS.

(a) IN GENERAL.—Section 55(a) is amended by striking ''There'' and inserting ''In the case of a taxpayer other than a corporation, there''.

(b) CONFORMING AMENDMENTS.—

(1) Section 38(c)(6) is amended by adding at the end the following new subparagraph:

''(E) CORPORATIONS.—In the case of a corporation, this subsection shall be applied by treating the corporation as having a tentative minimum tax of zero.''.

(2) Section 53(d)(2) is amended by inserting '', except that in the case of a corporation, the tentative minimum tax shall be treated as zero'' before the period at the end.

(3)(A) Section 55(b)(1) is amended to read as follows:

''(1) AMOUNT OF TENTATIVE TAX.—

''(A) IN GENERAL.—The tentative minimum tax for the taxable year is the sum of—

''(i) 26 percent of so much of the taxable excess as does not exceed $175,000, plus

''(ii) 28 percent of so much of the taxable excess as exceeds $175,000.

The amount determined under the preceding sentence shall be reduced by the alternative minimum tax foreign tax credit for the taxable year.

''(B) TAXABLE EXCESS.—For purposes of this subsection, the term 'taxable excess' means so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount.

''(C) MARRIED INDIVIDUAL FILING SEPARATE RETURN.—In the case of a married individual filing a separate return, subparagraph (A) shall be applied by substituting 50 percent of the dollar amount otherwise applicable under clause (i) and clause (ii) thereof. For purposes of the preceding sentence, marital status shall be determined under section 7703.''.

(B) Section 55(b)(3) is amended by striking ''paragraph (1)(A)(i)'' and inserting ''paragraph (1)(A)''.

(C) Section 59(a) is amended—

(i) by striking ''subparagraph (A)(i) or (B)(i) of section 55(b)(1) (whichever applies) in lieu of the highest rate of tax specified in section 1 or 11 (whichever applies)'' in paragraph (1)(C) and inserting ''section 55(b)(1) in lieu of the highest rate of tax specified in section 1'', and

(ii) in paragraph (2), by striking ''means'' and all that follows and inserting ''means the amount determined under the first sentence of section 55(b)(1)(A).''.

(D) Section 897(a)(2)(A) is amended by striking ''section 55(b)(1)(A)'' and inserting ''section 55(b)(1)''.

(E) Section 911(f) is amended—

(i) in paragraph (1)(B)—

(I) by striking ''section 55(b)(1)(A)(ii)'' and inserting ''section 55(b)(1)(B)'', and

(II) by striking ''section 55(b)(1)(A)(i)'' and inserting ''section 55(b)(1)(A)'', and

(ii) in paragraph (2)(B), by striking ''section 55(b)(1)(A)(ii)'' each place it appears and inserting ''section 55(b)(1)(B)''.

(4) Section 55(c)(1) is amended by striking '', the section 936 credit allowable under section 27(b), and the Puerto Rico economic activity credit under section 30A''.

(5) Section 55(d), as amended by section 11002, is amended—

(A) by striking paragraph (2) and redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively,

(B) in paragraph (2) (as so redesignated), by inserting ''and'' at the end of subparagraph (B), by striking '', and'' at the end of subparagraph (C) and inserting a period, and by striking subparagraph (D), and

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

(i) by striking ''(b)(1)(A)(i)'' in subparagraph (B)(i) and inserting ''(b)(1)(A)'', and

(ii) by striking ''paragraph (3)'' in subparagraph (B)(iii) and inserting ''paragraph (2)''.

(6) Section 55 is amended by striking subsection (e).

(7) Section 56(b)(2) is amended by striking subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(8)(A) Section 56 is amended by striking subsections (c) and (g).

(B) Section 847 is amended by striking the last sentence of paragraph (9).

(C) Section 848 is amended by striking subsection (i).

(9) Section 58(a) is amended by striking paragraph (3) and redesignating paragraph (4) as paragraph (3).

(10) Section 59 is amended by striking subsections (b) and (f).

(11) Section 11(d) is amended by striking ''the taxes imposed by subsection (a) and section 55'' and inserting ''the tax imposed by subsection (a)''.

(12) Section 12 is amended by striking paragraph (7).

(13) Section 168(k) is amended by striking paragraph (4).

(14) Section 882(a)(1) is amended by striking '', 55,''.

(15) Section 962(a)(1) is amended by striking ''sections 11 and 55'' and inserting ''section 11''.

(16) 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.

(17) Section 6425(c)(1)(A) is amended to read as follows:

''(A) the tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever is applicable, over''.

(18) Section 6655(e)(2) is amended by striking ''and alternative minimum taxable income'' each place it appears in subparagraphs (A) and (B)(i).

(19) Section 6655(g)(1)(A) is amended by inserting ''plus'' at the end of clause (i), by striking clause (ii), and by redesignating clause (iii) as clause (ii).

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

SEC. 12002. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY OF CORPORATIONS.

(a) 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 of a corporation beginning in 2018, 2019, 2020, or 2021, 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 2021) 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.''.

(b) TREATMENT OF REFERENCES.—Section 53(d) is amended by adding at the end the following new paragraph:

''(3) AMT TERM REFERENCES.—In the case of a corporation, any references in this subsection to section 55, 56, or 57 shall be treated as a reference to such section as in effect before the amendments made by Tax Cuts and Jobs Act.''.

(c) CONFORMING AMENDMENT.—Section 1374(b)(3)(B) is amended by striking the last sentence thereof.

(d) EFFECTIVE DATE.—

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

(2) CONFORMING AMENDMENT.—The amendment made by subsection (c) shall apply to taxable years beginning after December 31, 2021.

SEC. 12003. INCREASED EXEMPTION FOR INDIVIDUALS.

(a) IN GENERAL.—Section 55(d), as amended by the preceding provisions of this Act, is amended by adding at the end the following new paragraph:

''(4) SPECIAL RULE FOR TAXABLE YEARS BEGINNING AFTER 2017 AND BEFORE 2026.—

''(A) IN GENERAL.—In the case of any taxable year beginning after December 31, 2017, and before January 1, 2026—

''(i) paragraph (1) shall be applied—

''(I) by substituting '$109,400' for '$78,750' in subparagraph (A), and

''(II) by substituting '$70,300' for '$50,600' in subparagraph (B), and

''(ii) paragraph (2) shall be applied—

''(I) by substituting '$1,000,000' for '$150,000' in subparagraph (A),

''(II) by substituting '50 percent of the dollar amount applicable under subparagraph (A)' for '$112,500' in subparagraph (B), and

''(III) in the case of a taxpayer described in paragraph (1)(D), without regard to the substitution under subclause (I).

''(B) INFLATION ADJUSTMENT.—

''(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2018, the amounts described in clause (ii) shall each be increased by an amount equal to—

''(I) such dollar amount, multiplied by

''(II) the cost-of-living adjustment determined under section 1(f)(3) 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.

''(ii) AMOUNTS DESCRIBED.—The amounts described in this clause are the $109,400 amount in subparagraph (A)(i)(I), the $70,300 amount in subparagraph (A)(i)(II), and the $1,000,000 amount in subparagraph (A)(ii)(I).

''(iii) ROUNDING.—Any increased amount determined under clause (i) shall be rounded to the nearest multiple of $100.

''(iv) COORDINATION WITH CURRENT ADJUSTMENTS.—In the case of any taxable year to which subparagraph (A) applies, no adjustment shall be made under paragraph (3) to any of the numbers which are substituted under subparagraph (A) and adjusted under this subparagraph.''.

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

Subtitle C—Business-related Provisions

PART I—CORPORATE PROVISIONS

SEC. 13001. 21-PERCENT CORPORATE TAX RATE.

(a) IN GENERAL.—Subsection (b) of section 11 is amended to read as follows:

''(b) AMOUNT OF TAX.—The amount of the tax imposed by subsection (a) shall be 21 percent of taxable income.''.

(b) CONFORMING AMENDMENTS.—

(1) The following sections are each amended by striking ''section 11(b)(1)'' and inserting ''section 11(b)'':

(A) Section 280C(c)(3)(B)(ii)(II).

(B) Paragraphs (2)(B) and (6)(A)(ii) of section 860E(e).

(C) Section 7874(e)(1)(B).

(2)(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 paragraphs (4) and (6), and by redesignating paragraph (5) as paragraph (4).

(C) Section 453A(c)(3) is amended by striking ''or 1201 (whichever is appropriate)''.

(D) 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''.

(E) Sections 594(a) is amended by striking ''taxes imposed by section 11 or 1201(a)'' and inserting ''tax imposed by section 11''.

(F) Section 691(c)(4) is amended by striking ''1201,''.

(G) 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''.

(H) Section 831(e) is amended by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(I) Sections 832(c)(5) and 834(b)(1)(D) are each amended by striking ''sec. 1201 and following,''.

(J) Section 852(b)(3)(A) is amended by striking ''section 1201(a)'' and inserting ''section 11(b)''.

(K) 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.''.

(L) Section 882(a)(1), as amended by section 12001, is further amended by striking ''or 1201(a)''.

(M) Section 904(b) is amended—

(i) by striking ''or 1201(a)'' in paragraph (2)(C),

(ii) by striking paragraph (3)(D) and inserting the following:

''(D) CAPITAL GAIN RATE DIFFERENTIAL.—There is a capital gain rate differential for any year if subsection (h) of section 1 applies to such taxable year.'', and

(iii) by striking paragraph (3)(E) and inserting the following:

''(E) RATE DIFFERENTIAL PORTION.—The rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as—

''(i) the excess of—

''(I) the highest rate of tax set forth in subsection (a), (b), (c), (d), or (e) of section 1 (whichever applies), over

''(II) the alternative rate of tax determined under section 1(h), bears to

''(ii) that rate referred to in subclause (I).''.

(N) Section 1374(b) is amended by striking paragraph (4).

(O) Section 1381(b) is amended by striking ''taxes imposed by section 11 or 1201'' and inserting ''tax imposed by section 11''.

(P) Sections 6425(c)(1)(A), as amended by section 12001, and 6655(g)(1)(A)(i) are each amended by striking ''or 1201(a),''.

(Q) Section 7518(g)(6)(A) is amended by striking ''or 1201(a)''.

(3)(A) Section 1445(e)(1) is amended—

(i) by striking ''35 percent'' and inserting ''the highest rate of tax in effect for the taxable year under section 11(b)'', and

(ii) by striking ''of the gain'' and inserting ''multiplied by the gain''.

(B) Section 1445(e)(2) is amended by striking ''35 percent of the amount'' and inserting ''the highest rate of tax in effect for the taxable year under section 11(b) multiplied by the amount''.

(C) Section 1445(e)(6) is amended—

(i) by striking ''35 percent'' and inserting ''the highest rate of tax in effect for the taxable year under section 11(b)'', and

(ii) by striking ''of the amount'' and inserting ''multiplied by the amount''.

(D) Section 1446(b)(2)(B) is amended by striking ''section 11(b)(1)'' and inserting ''section 11(b)''.

(4) Section 852(b)(1) is amended by striking the last sentence.

(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 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 section 12001, 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) EFFECTIVE DATE.—

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

(2) WITHHOLDING.—The amendments made by subsection (b)(3) shall apply to distributions made after December 31, 2017.

(3) CERTAIN TRANSFERS.—The amendments made by subsection (b)(6) shall apply to transfers made after December 31, 2017.

(d) 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 of the day before the corporate rate reductions provided in the amendments made by this section take effect, 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, during the time period in which the 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 for the corporate rate reductions provided in the amendments made by this section—

(A) 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, and

(B) such taxpayer shall not be treated as using a normalization method of accounting for purposes of subsections (f)(2) and (i)(9)(C) of section 168 of the Internal Revenue Code of 1986.

SEC. 13002. REDUCTION IN DIVIDEND RECEIVED DEDUCTIONS TO REFLECT LOWER CORPORATE INCOME TAX RATES.

(a) DIVIDENDS RECEIVED BY CORPORATIONS.—

(1) IN GENERAL.—Section 243(a)(1) is amended by striking ''70 percent'' and inserting ''50 percent''.

(2) DIVIDENDS FROM 20-PERCENT OWNED CORPORATIONS.—Section 243(c)(1) is amended—

(A) by striking ''80 percent'' and inserting ''65 percent'', and

(B) by striking ''70 percent'' and inserting ''50 percent''.

(3) CONFORMING AMENDMENT.—The heading for section 243(c) is amended by striking ''RETENTION OF 80-PERCENT DIVIDEND RECEIVED DEDUCTION'' and inserting ''INCREASED PERCENTAGE''.

(b) DIVIDENDS RECEIVED FROM FSC.—Section 245(c)(1)(B) is amended—

(1) by striking ''70 percent'' and inserting ''50 percent'', and

(2) by striking ''80 percent'' and inserting ''65 percent''.

(c) LIMITATION ON AGGREGATE AMOUNT OF DEDUCTIONS.—Section 246(b)(3) is amended—

(1) by striking ''80 percent'' in subparagraph (A) and inserting ''65 percent'', and

(2) by striking ''70 percent'' in subparagraph (B) and inserting ''50 percent''.

(d) REDUCTION IN DEDUCTION WHERE PORTFOLIO STOCK IS DEBT-FINANCED.—Section 246A(a)(1) is amended—

(1) by striking ''70 percent'' and inserting ''50 percent'', and

(2) by striking ''80 percent'' and inserting ''65 percent''.

(e) INCOME FROM SOURCES WITHIN THE UNITED STATES.—Section 861(a)(2) is amended—

(1) by striking ''100/70th'' and inserting ''100/50th'' in subparagraph (B), and

(2) in the flush sentence at the end—

(A) by striking ''100/80th'' and inserting ''100/65th'', and

(B) by striking ''100/70th'' and inserting ''100/50th''.

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

PART II—SMALL BUSINESS REFORMS

SEC. 13101. MODIFICATIONS OF RULES FOR EXPENSING DEPRECIABLE BUSINESS ASSETS.

(a) INCREASE IN LIMITATION.—

(1) DOLLAR LIMITATION.—Section 179(b)(1) is amended by striking ''$500,000'' and inserting ''$1,000,000''.

(2) REDUCTION IN LIMITATION.—Section 179(b)(2) is amended by striking ''$2,000,000'' and inserting ''$2,500,000''.

(3) INFLATION ADJUSTMENTS.—

(A) IN GENERAL.—Subparagraph (A) of section 179(b)(6), as amended by section 11002(d), is amended—

(i) by striking ''2015'' and inserting ''2018'', and

(ii) in clause (ii), by striking ''calendar year 2014'' and inserting ''calendar year 2017''.

(B) SPORT UTILITY VEHICLES.—Section 179(b)(6) is amended—

(i) in subparagraph (A), by striking ''paragraphs (1) and (2)'' and inserting ''paragraphs (1), (2), and (5)(A)'', and

(ii) in subparagraph (B), by inserting ''($100 in the case of any increase in the amount under paragraph (5)(A))'' after ''$10,000''.

(b) Section 179 Property To Include Qualified Real Property.—

(1) IN GENERAL.—Subparagraph (B) of section 179(d)(1) is amended to read as follows:

''(B) which is—

''(i) section 1245 property (as defined in section 1245(a)(3)), or

''(ii) at the election of the taxpayer, qualified real property (as defined in subsection (f)), and''.

(2) QUALIFIED REAL PROPERTY DEFINED.—Subsection (f) of section 179 is amended to read as follows:

''(f) QUALIFIED REAL PROPERTY.—For purposes of this section, the term 'qualified real property' means—

''(1) any qualified improvement property described in section 168(e)(6), and

''(2) any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service:

''(A) Roofs.

''(B) Heating, ventilation, and air-conditioning property.

''(C) Fire protection and alarm systems.

''(D) Security systems.''.

(c) REPEAL OF EXCLUSION FOR CERTAIN PROPERTY.—The last sentence of section 179(d)(1) is amended by inserting ''(other than paragraph (2) thereof)'' after ''section 50(b)''.

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

SEC. 13102. 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(f)(3) 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' has the meaning given the term in section 451(b)(3).

''(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.

PART III—COST RECOVERY AND ACCOUNTING METHODS

Subpart A—Cost Recovery

SEC. 13201. TEMPORARY 100-PERCENT EXPENSING FOR CERTAIN BUSINESS ASSETS.

(a) INCREASED EXPENSING.—

(1) IN GENERAL.—Section 168(k) is amended—

(A) in paragraph (1)(A), by striking ''50 percent'' and inserting ''the applicable percentage'', and

(B) in paragraph (5)(A)(i), by striking ''50 percent'' and inserting ''the applicable percentage''.

(2) APPLICABLE PERCENTAGE.—Paragraph (6) of section 168(k) is amended to read as follows:

''(6) APPLICABLE PERCENTAGE.—For purposes of this subsection—

''(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term 'applicable percentage' means—

''(i) in the case of property placed in service after September 27, 2017, and before January 1, 2023, 100 percent,

''(ii) in the case of property placed in service after December 31, 2022, and before January 1, 2024, 80 percent,

''(iii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 60 percent,

''(iv) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 40 percent, and

''(v) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 20 percent.

''(B) RULE FOR PROPERTY WITH LONGER PRODUCTION PERIODS.—In the case of property described in subparagraph (B) or (C) of paragraph (2), the term 'applicable percentage' means—

''(i) in the case of property placed in service after September 27, 2017, and before January 1, 2024, 100 percent,

''(ii) in the case of property placed in service after December 31, 2023, and before January 1, 2025, 80 percent,

''(iii) in the case of property placed in service after December 31, 2024, and before January 1, 2026, 60 percent,

''(iv) in the case of property placed in service after December 31, 2025, and before January 1, 2027, 40 percent, and

''(v) in the case of property placed in service after December 31, 2026, and before January 1, 2028, 20 percent.

''(C) RULE FOR PLANTS BEARING FRUITS AND NUTS.—In the case of a specified plant described in paragraph (5), the term 'applicable percentage' means—

''(i) in the case of a plant which is planted or grafted after September 27, 2017, and before January 1, 2023, 100 percent,

''(ii) in the case of a plant which is planted or grafted after December 31, 2022, and before January 1, 2024, 80 percent,

''(iii) in the case of a plant which is planted or grafted after December 31, 2023, and before January 1, 2025, 60 percent,

''(iv) in the case of a plant which is planted or grafted after December 31, 2024, and before January 1, 2026, 40 percent, and

''(v) in the case of a plant which is planted or grafted after December 31, 2025, and before January 1, 2027, 20 percent.''.

(3) CONFORMING AMENDMENT.—

(A) Paragraph (5) of section 168(k) is amended by striking subparagraph (F).

(B) Section 168(k) is amended by adding at the end the following new paragraph:

''(8) 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 (6) shall be applied by substituting for each percentage therein—

''(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,

''(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, and

''(D) '0 percent' in the case of—

''(i) property placed in service after 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 after 2020.''.

(b) EXTENSION.—

(1) IN GENERAL.—Section 168(k) is amended—

(A) in paragraph (2)—

(i) in subparagraph (A)(iii), clauses (i)(III) and (ii) of subparagraph (B), and subparagraph (E)(i), by striking ''January 1, 2020'' each place it appears and inserting ''January 1, 2027'', and

(ii) in subparagraph (B)—

(I) in clause (i)(II), by striking ''January 1, 2021'' and inserting ''January 1, 2028'', and

(II) in the heading of clause (ii), by striking ''PRE-JANUARY 1, 2020'' and inserting ''PRE-JANUARY 1, 2027'', and

(B) in paragraph (5)(A), by striking ''January 1, 2020'' and inserting ''January 1, 2027''.

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 460(c)(6)(B) is amended by striking ''January 1, 2020 (January 1, 2021'' and inserting ''January 1, 2027 (January 1, 2028''.

(B) The heading of section 168(k) is amended by striking ''ACQUIRED AFTER DECEMBER 31, 2007, AND BEFORE JANUARY 1, 2020''.

(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 PROPERTY.—Section 168(k), as amended by this section, is amended by adding at the end the following new paragraph:

''(9) EXCEPTION FOR CERTAIN PROPERTY.—The term 'qualified property' shall not include—

''(A) any property which is primarily used in a trade or business described in clause (iv) of section 163(j)(7)(A), or

''(B) any property used in 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) SPECIAL RULE.—Section 168(k), as amended by this section, is amended by adding at the end the following new paragraph:

''(10) SPECIAL RULE FOR PROPERTY PLACED IN SERVICE DURING CERTAIN PERIODS.—

''(A) IN GENERAL.—In the case of qualified property placed in service by the taxpayer during the first taxable year ending after September 27, 2017, if the taxpayer elects to have this paragraph apply for such taxable year, paragraphs (1)(A) and (5)(A)(i) shall be applied by substituting '50 percent' for 'the applicable percentage'.

''(B) FORM OF ELECTION.—Any election under this paragraph shall be made at such time and in such form and manner as the Secretary may prescribe.''.

(f) COORDINATION WITH SECTION 280F.—Clause (iii) of section 168(k)(2)(F) is amended 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''.

(g) QUALIFIED FILM AND TELEVISION AND LIVE THEATRICAL PRODUCTIONS.—

(1) IN GENERAL.—Clause (i) of section 168(k)(2)(A), as amended by section 13204, is amended—

(A) in subclause (II), by striking ''or'',

(B) in subclause (III), by adding ''or'' after the comma, and

(C) by adding at the end the following:

''(IV) which is a qualified film or television production (as defined in subsection (d) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection, or

''(V) which is a qualified live theatrical production (as defined in subsection (e) of section 181) for which a deduction would have been allowable under section 181 without regard to subsections (a)(2) and (g) of such section or this subsection,''.

(2) PRODUCTION PLACED IN SERVICE.—Paragraph (2) of section 168(k) is amended by adding at the end the following:

''(H) PRODUCTION PLACED IN SERVICE.—For purposes of subparagraph (A)—

''(i) a qualified film or television production shall be considered to be placed in service at the time of initial release or broadcast, and

''(ii) a qualified live theatrical production shall be considered to be placed in service at the time of the initial live staged performance.''.

(h) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as 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 this section shall apply to specified plants planted or grafted after September 27, 2017.

SEC. 13202. MODIFICATIONS TO DEPRECIATION LIMITATIONS ON LUXURY AUTOMOBILES AND PERSONAL USE PROPERTY.

(a) LUXURY AUTOMOBILES.—

(1) IN GENERAL.—280F(a)(1)(A) is amended—

(A) in clause (i), by striking ''$2,560'' and inserting ''$10,000'',

(B) in clause (ii), by striking ''$4,100'' and inserting ''$16,000'',

(C) in clause (iii), by striking ''$2,450'' and inserting ''$9,600'', and

(D) in clause (iv), by striking ''$1,475'' and inserting ''$5,760''.

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 280F(a)(1)(B) is amended by striking ''$1,475'' in the text and heading and inserting ''$5,760''.

(B) Paragraph (7) of section 280F(d) is amended—

(i) in subparagraph (A), by striking ''1988'' and inserting ''2018'', and

(ii) in subparagraph (B)(i)(II), by striking ''1987'' and inserting ''2017''.

(b) REMOVAL OF COMPUTER EQUIPMENT FROM LISTED PROPERTY.—

(1) IN GENERAL.—Section 280F(d)(4)(A) is amended—

(A) by inserting ''and'' at the end of clause (iii),

(B) by striking clause (iv), and

(C) by redesignating clause (v) as clause (iv).

(2) CONFORMING AMENDMENT.—Section 280F(d)(4) is amended by striking subparagraph (B) and by redesignating subparagraph (C) as subparagraph (B).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2017, in taxable years ending after such date.

SEC. 13203. MODIFICATIONS OF TREATMENT OF CERTAIN FARM PROPERTY.

(a) TREATMENT OF CERTAIN FARM PROPERTY AS 5-YEAR PROPERTY.—Clause (vii) of section 168(e)(3)(B) is amended by striking ''after December 31, 2008, and which is placed in service before January 1, 2010'' and inserting ''after December 31, 2017,''.

(b) REPEAL OF REQUIRED USE OF 150-PERCENT DECLINING BALANCE METHOD.—Section 168(b)(2) is amended by striking subparagraph (B) and by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2017, in taxable years ending after such date.

SEC. 13204. APPLICABLE RECOVERY PERIOD FOR REAL PROPERTY.

(a) IMPROVEMENTS TO REAL PROPERTY.—

(1) ELIMINATION OF QUALIFIED LEASEHOLD IMPROVEMENT, QUALIFIED RESTAURANT, AND QUALIFIED RETAIL IMPROVEMENT PROPERTY.—Subsection (e) of section 168 is amended—

(A) in subparagraph (E) of paragraph (3)—

(i) by striking clauses (iv), (v), and (ix),

(ii) in clause (vii), by inserting ''and'' at the end,

(iii) in clause (viii), by striking '', and'' and inserting a period, and

(iv) by redesignating clauses (vi), (vii), and (viii), as so amended, as clauses (iv), (v), and (vi), respectively, and

(B) by striking paragraphs (6), (7), and (8).

(2) APPLICATION OF STRAIGHT LINE METHOD TO QUALIFIED IMPROVEMENT PROPERTY.—Paragraph (3) of section 168(b) is amended—

(A) by striking subparagraphs (G), (H), and (I), and

(B) by inserting after subparagraph (F) the following new subparagraph:

''(G) Qualified improvement property described in subsection (e)(6).''.

(3) ALTERNATIVE DEPRECIATION SYSTEM.—

(A) ELECTING REAL PROPERTY TRADE OR BUSINESS.—Subsection (g) of section 168 is amended—

(i) in paragraph (1)—

(I) in subparagraph (D), by striking ''and'' at the end,

(II) in subparagraph (E), by inserting ''and'' at the end, and

(III) by inserting after subparagraph (E) the following new subparagraph:

''(F) any property described in paragraph (8),'', and

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

''(8) ELECTING REAL PROPERTY TRADE OR BUSINESS.—The property described in this paragraph shall consist of any nonresidential real property, residential rental property, and qualified improvement property held by an electing real property trade or business (as defined in 163(j)(7)(B)).''.

(B) QUALIFIED IMPROVEMENT PROPERTY.—The table contained in subparagraph (B) of section 168(g)(3) is amended—

(i) by inserting after the item relating to subparagraph (D)(ii) the following new item:

''(D)(v) .... 20''

, and

(ii) by striking the item relating to subparagraph (E)(iv) and all that follows through the item relating to subparagraph (E)(ix) and inserting the following:

''(E)(iv) 20
(E)(v) 30
(E)(vi) .... 35''.

(C) APPLICABLE RECOVERY PERIOD FOR RESIDENTIAL RENTAL PROPERTY.—The table contained in subparagraph (C) of section 168(g)(2) is amended by striking clauses (iii) and (iv) and inserting the following:

''(iii) Residential rental property 30 years
(iv) Nonresidential real property .. 40 years
(v) Any railroad grading or tunnel bore or water utility property .... 50 years''.

(4) CONFORMING AMENDMENTS.—

(A) Clause (i) of section 168(k)(2)(A) is amended—

(i) in subclause (II), by inserting ''or'' after the comma,

(ii) in subclause (III), by striking ''or'' at the end, and

(iii) by striking subclause (IV).

(B) Section 168 is amended—

(i) in subsection (e), as amended by paragraph (1)(B), by adding at the end the following:

''(6) QUALIFIED IMPROVEMENT PROPERTY.—

''(A) IN GENERAL.—The term 'qualified improvement property' means any improvement to an interior portion of a building which is nonresidential real property if such improvement is placed in service after the date such building was first placed in service.

''(B) CERTAIN IMPROVEMENTS NOT INCLUDED.—Such term shall not include any improvement for which the expenditure is attributable to—

''(i) the enlargement of the building,

''(ii) any elevator or escalator, or

''(iii) the internal structural framework of the building.'', and

(ii) in subsection (k), by striking paragraph (3).

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to property placed in service after December 31, 2017.

(2) AMENDMENTS RELATED TO ELECTING REAL PROPERTY TRADE OR BUSINESS.—The amendments made by subsection (a)(3)(A) shall apply to taxable years beginning after December 31, 2017.

SEC. 13205. USE OF ALTERNATIVE DEPRECIATION SYSTEM FOR ELECTING FARMING BUSINESSES.

(a) IN GENERAL.—Section 168(g)(1), as amended by section 13204, is amended by striking ''and'' at the end of subparagraph (E), by inserting ''and'' at the end of subparagraph (F), and by inserting after subparagraph (F) the following new subparagraph:

''(G) any property with a recovery period of 10 years or more which is held by an electing farming business (as defined in section 163(j)(7)(C)),''.

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

SEC. 13206. 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) CHANGE IN METHOD OF ACCOUNTING.—The amendments made by subsection (a) shall be treated as a change in method of accounting for purposes of section 481 of the Internal Revenue Code of 1986 and—

(1) such change shall be treated as initiated by the taxpayer,

(2) such change shall be treated as made with the consent of the Secretary, and

(3) such change shall be applied only on a cut-off basis for any research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2021, and no adjustments under section 481(a) shall be made.

(c) 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:

''Sec. 174. Amortization of research and experimental expenditures.''.

(d) CONFORMING AMENDMENTS.—

(1) Section 41(d)(1)(A) is amended by striking ''expenses under section 174'' and inserting ''specified research or experimental expenditures under section 174''.

(2) Subsection (c) of section 280C is amended—

(A) by striking paragraph (1) and inserting the following:

''(1) IN GENERAL.—If—

''(A) the amount of the credit determined for the taxable year under section 41(a)(1), exceeds

''(B) the amount allowable as a deduction for such taxable year for qualified research expenses or basic research expenses,

the amount chargeable to capital account for the taxable year for such expenses shall be reduced by the amount of such excess.'',

(B) by striking paragraph (2),

(C) by redesignating paragraphs (3) (as amended by this Act) and (4) as paragraphs (2) and (3), respectively, and

(D) in paragraph (2), as redesignated by subparagraph (C), by striking ''paragraphs (1) and (2)'' and inserting ''paragraph (1)''.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 2021.

SEC. 13207. EXPENSING OF CERTAIN COSTS OF REPLANTING CITRUS PLANTS LOST BY REASON OF CASUALTY.

(a) IN GENERAL.—Section 263A(d)(2) is amended by adding at the end the following new subparagraph:

''(C) SPECIAL TEMPORARY RULE FOR CITRUS PLANTS LOST BY REASON OF CASUALTY.—

''(i) IN GENERAL.—In the case of the replanting of citrus plants, subparagraph (A) shall apply to amounts paid or incurred by a person (other than the taxpayer described in subparagraph (A)) if—

''(I) the taxpayer described in subparagraph (A) has an equity interest of not less than 50 percent in the replanted citrus plants at all times during the taxable year in which such amounts were paid or incurred and such other person holds any part of the remaining equity interest, or

''(II) such other person acquired the entirety of such taxpayer's equity interest in the land on which the lost or damaged citrus plants were located at the time of such loss or damage, and the replanting is on such land.

''(ii) TERMINATION.—Clause (i) shall not apply to any cost paid or incurred after the date which is 10 years after the date of the enactment of the Tax Cuts and Jobs Act.''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to costs paid or incurred after the date of the enactment of this Act.

Subpart B—Accounting Methods

SEC. 13221. CERTAIN SPECIAL RULES FOR TAXABLE YEAR OF INCLUSION.

(a) INCLUSION NOT LATER THAN FOR FINANCIAL ACCOUNTING PURPOSES.—Section 451 is amended by redesignating subsections (b) through (i) as subsections (c) through (j), respectively, and by inserting after subsection (a) the following new subsection:

''(b) INCLUSION NOT LATER THAN FOR FINANCIAL ACCOUNTING PURPOSES.—

''(1) INCOME TAKEN INTO ACCOUNT IN FINANCIAL STATEMENT.—

''(A) IN GENERAL.—In the case of a taxpayer the taxable income of which is computed under

an accrual method of accounting, the all events test with respect to any item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in—

''(i) an applicable financial statement of the taxpayer, or

''(ii) such other financial statement as the Secretary may specify for purposes of this subsection.

''(B) EXCEPTION.—This paragraph shall not apply to—

''(i) a taxpayer which does not have a financial statement described in clause (i) or (ii) of subparagraph (A) for a taxable year, or

''(ii) any item of gross income in connection with a mortgage servicing contract.

''(C) ALL EVENTS TEST.—For purposes of this section, the all events test is met with respect to any item of gross income if all the events have occurred which fix the right to receive such income and the amount of such income can be determined with reasonable accuracy.

''(2) COORDINATION WITH SPECIAL METHODS OF ACCOUNTING.—Paragraph (1) shall not apply with respect to any item of gross income for which the taxpayer uses a special method of accounting provided under any other provision of this chapter, other than any provision of part V of subchapter P (except as provided in clause (ii) of paragraph (1)(B)).

''(3) 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 agency for purposes other than Federal tax purposes, but only if there is no statement of the taxpayer described in clause (i) or (ii),

''(B) a financial statement which is made on the basis of international financial reporting standards and is filed by the taxpayer with an agency of a foreign government which is equivalent to the United States Securities and Exchange Commission and which has reporting standards not less stringent than the standards required by such Commission, but only if there is no statement of the taxpayer described in subparagraph (A), or

''(C) a financial statement filed by the taxpayer with any other regulatory or governmental body specified by the Secretary, but only if there is no statement of the taxpayer described in subparagraph (A) or (B).

''(4) ALLOCATION OF TRANSACTION PRICE.—For purposes of this subsection, in the case of a contract which contains multiple performance obligations, the allocation of the transaction price to each performance obligation shall be equal to the amount allocated to each performance obligation for purposes of including such item in revenue in the applicable financial statement of the taxpayer.

''(5) GROUP OF ENTITIES.—For purposes of paragraph (1), if the financial results of a taxpayer are reported on the applicable financial statement (as defined in paragraph (3)) for a group of entities, such statement shall be treated as the applicable financial statement of the taxpayer.''.

(b) TREATMENT OF ADVANCE PAYMENTS.—Section 451, as amended by subsection (a), is amended by redesignating subsections (c) through (j) as subsections (d) through (k), respectively, and by inserting after subsection (b) the following new subsection:

''(c) TREATMENT OF ADVANCE PAYMENTS.—

''(1) IN GENERAL.—A taxpayer which computes taxable income under the accrual method of accounting, and receives any advance payment during the taxable year, shall—

''(A) except as provided in subparagraph (B), include such advance payment in gross income for such taxable year, or

''(B) if the taxpayer elects the application of this subparagraph with respect to the category of advance payments to which such advance payment belongs, the taxpayer shall—

''(i) to the extent that any portion of such advance payment is required under subsection (b) to be included in gross income in the taxable year in which such payment is received, so include such portion, and

''(ii) include the remaining portion of such advance payment in gross income in the taxable year following the taxable year in which such payment is received.

''(2) ELECTION.—

''(A) IN GENERAL.—Except as otherwise provided in this paragraph, the election under paragraph (1)(B) shall be made at such time, in such form and manner, and with respect to such categories of advance payments, as the Secretary may provide.

''(B) PERIOD TO WHICH ELECTION APPLIES.—An election under paragraph (1)(B) shall be effective for the taxable year with respect to which it is first made and for all subsequent taxable years, unless the taxpayer secures the consent of the Secretary to revoke such election. For purposes of this title, the computation of taxable income under an election made under paragraph (1)(B) shall be treated as a method of accounting.

''(3) TAXPAYERS CEASING TO EXIST.—Except as otherwise provided by the Secretary, the election under paragraph (1)(B) shall not apply with respect to advance payments received by the taxpayer during a taxable year if such taxpayer ceases to exist during (or with the close of) such taxable year.

''(4) ADVANCE PAYMENT.—For purposes of this subsection—

''(A) IN GENERAL.—The term 'advance payment' means any payment—

''(i) the full inclusion of which in the gross income of the taxpayer for the taxable year of receipt is a permissible method of accounting under this section (determined without regard to this subsection),

''(ii) any portion of which is included in revenue by the taxpayer in a financial statement described in clause (i) or (ii) of subsection (b)(1)(A) for a subsequent taxable year, and

''(iii) which is for goods, services, or such other items as may be identified by the Secretary for purposes of this clause.

''(B) EXCLUSIONS.—Except as otherwise provided by the Secretary, such term shall not include—

''(i) rent,

''(ii) insurance premiums governed by subchapter L,

''(iii) payments with respect to financial instruments,

''(iv) payments with respect to warranty or guarantee contracts under which a third party is the primary obligor,

''(v) payments subject to section 871(a), 881, 1441, or 1442,

''(vi) payments in property to which section 83 applies, and

''(vii) any other payment identified by the Secretary for purposes of this subparagraph.

''(C) RECEIPT.—For purposes of this subsection, an item of gross income is received by the taxpayer if it is actually or constructively received, or if it is due and payable to the taxpayer.

''(D) ALLOCATION OF TRANSACTION PRICE.—For purposes of this subsection, rules similar to subsection (b)(4) shall apply.''.

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

(d) COORDINATION WITH SECTION 481.—

(1) IN GENERAL.—In the case of any qualified change in method of accounting for the taxpayer's first taxable year beginning after December 31, 2017—

(A) such change shall be treated as initiated by the taxpayer, and

(B) such change shall be treated as made with the consent of the Secretary of the Treasury.

(2) QUALIFIED CHANGE IN METHOD OF ACCOUNTING.—For purposes of this subsection, the term ''qualified change in method of accounting'' means any change in method of accounting which—

(A) is required by the amendments made by this section, or

(B) was prohibited under the Internal Revenue Code of 1986 prior to such amendments and is permitted under such Code after such amendments.

(e) SPECIAL RULES FOR ORIGINAL ISSUE DISCOUNT.—Notwithstanding subsection (c), in the case of income from a debt instrument having original issue discount—

(1) the amendments made by this section shall apply to taxable years beginning after December 31, 2018, and

(2) the period for taking into account any adjustments under section 481 by reason of a qualified change in method of accounting (as defined in subsection (d)) shall be 6 years.

PART IV—BUSINESS-RELATED EXCLUSIONS AND DEDUCTIONS

SEC. 13301. LIMITATION ON DEDUCTION FOR INTEREST.

(a) IN GENERAL.—Section 163(j) is amended to read as follows:

''(j) LIMITATION ON BUSINESS INTEREST.—

''(1) IN GENERAL.—The amount allowed as a deduction under this chapter for any taxable year 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) shall not be less than zero.

''(2) CARRYFORWARD OF DISALLOWED BUSINESS INTEREST.—The amount of any business interest not allowed as a deduction for any taxable year by reason of paragraph (1) shall be treated as business interest paid or accrued in the succeeding taxable year.

''(3) 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.

''(4) 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, and

''(ii) the adjusted taxable income of each partner of such partnership—

''(I) shall be determined without regard to such partner's distributive share of any items of income, gain, deduction, or loss of such partnership, and

''(II) shall be increased by such partner's distributive share of such partnership's excess taxable income.

For purposes of clause (ii)(II), a partner's distributive share of partnership excess taxable income shall be determined in the same manner as the partner's distributive share of nonseparately stated taxable income or loss of the partnership.

''(B) SPECIAL RULES FOR CARRYFORWARDS.—

''(i) IN GENERAL.—The amount of any business interest not allowed as a deduction to a partnership for any taxable year by reason of paragraph (1) for any taxable year—

''(I) shall not be treated under paragraph (2) as business interest paid or accrued by the partnership in the succeeding taxable year, and

''(II) shall, subject to clause (ii), be treated as excess business interest which is allocated to each partner in the same manner as the nonseparately stated taxable income or loss of the partnership.

''(ii) TREATMENT OF EXCESS BUSINESS INTEREST ALLOCATED TO PARTNERS.—If a partner is allocated any excess business interest from a partnership under clause (i) for any taxable year—

''(I) such excess business interest shall be treated as business interest paid or accrued by the partner in the next succeeding taxable year in which the partner is allocated excess taxable income from such partnership, but only to the extent of such excess taxable income, and

''(II) any portion of such excess business interest remaining after the application of subclause (I) shall, subject to the limitations of subclause (I), be treated as business interest paid or accrued in succeeding taxable years.

For purposes of applying this paragraph, excess taxable income allocated to a partner from a partnership for any taxable year shall not be taken into account under paragraph (1)(A) with respect to any business interest other than excess business interest from the partnership until all such excess business interest for such taxable year and all preceding taxable years has been treated as paid or accrued under clause (ii).

''(iii) BASIS ADJUSTMENTS.—

''(I) IN GENERAL.—The adjusted basis of a partner in a partnership interest shall be reduced (but not below zero) by the amount of excess business interest allocated to the partner under clause (i)(II).

''(II) SPECIAL RULE FOR DISPOSITIONS.—If a partner disposes of a partnership interest, the adjusted basis of the partner in the partnership interest shall be increased immediately before the disposition by the amount of the excess (if any) of the amount of the basis reduction under subclause (I) over the portion of any excess business interest allocated to the partner under clause (i)(II) which has previously been treated under clause (ii) as business interest paid or accrued by the partner. The preceding sentence shall also apply to transfers of the partnership interest (including by reason of death) in a transaction in which gain is not recognized in whole or in part. No deduction shall be allowed to the transferor or transferee under this chapter for any excess business interest resulting in a basis increase under this subclause.

''(C) EXCESS TAXABLE INCOME.—The term 'excess taxable income' means, with respect to any partnership, the amount which bears the same ratio to the partnership's adjusted taxable income as—

''(i) the excess (if any) of—

''(I) the amount determined for the partnership under paragraph (1)(B), over

''(II) the amount (if any) by which the business interest of the partnership, reduced by the floor plan financing interest, exceeds the business interest income of the partnership, bears to

''(ii) the amount determined for the partnership under paragraph (1)(B).

''(D) APPLICATION TO S CORPORATIONS.—Rules similar to the rules of subparagraphs (A) and (C) shall apply with respect to any S corporation and its shareholders.

''(5) 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)).

''(6) 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)).

''(7) TRADE OR BUSINESS.—For purposes of this subsection—

''(A) IN GENERAL.—The term 'trade or business' shall not include—

''(i) the trade or business of performing services as an employee,

''(ii) any electing real property trade or business,

''(iii) any electing farming business, or

''(iv) 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, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

''(B) ELECTING REAL PROPERTY TRADE OR BUSINESS.—For purposes of this paragraph, the term 'electing real property trade or business' means any trade or business which is described in section 469(c)(7)(C) and which makes an election under this subparagraph. Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

''(C) ELECTING FARMING BUSINESS.—For purposes of this paragraph, the term 'electing farming business' means—

''(i) a farming business (as defined in section 263A(e)(4)) which makes an election under this subparagraph, or

''(ii) any trade or business of a specified agricultural or horticultural cooperative (as defined in section 199A(g)(2)) with respect to which the cooperative makes an election under this subparagraph.

Any such election shall be made at such time and in such manner as the Secretary shall prescribe, and, once made, shall be irrevocable.

''(8) 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,

''(iv) the amount of any deduction allowed under section 199A, and

''(v) in the case of taxable years beginning before January 1, 2022, any deduction allowable for depreciation, amortization, or depletion, and

''(B) computed with such other adjustments as provided by the Secretary.

''(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 or lease, 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) Any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road.

''(ii) A boat.

''(iii) Farm machinery or equipment.

''(10) CROSS REFERENCES.—

''(A) For requirement that an electing real property trade or business use the alternative depreciation system, see section 168(g)(1)(F).

''(B) For requirement that an electing farming business use the alternative depreciation system, see section 168(g)(1)(G).''.

(b) 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 BUSINESS INTEREST.—The carryover of disallowed business interest described in section 163(j)(2) 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(j)(2) 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).''.

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

SEC. 13302. MODIFICATION OF NET OPERATING LOSS DEDUCTION.

(a) LIMITATION ON DEDUCTION.—

(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) 80 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'.''.

(b) REPEAL OF NET OPERATING LOSS CARRYBACK; INDEFINITE CARRYFORWARD.—

(1) IN GENERAL.—Section 172(b)(1)(A) is amended—

(A) by striking ''shall be a net operating loss carryback to each of the 2 taxable years'' in clause (i) and inserting ''except as otherwise provided in this paragraph, shall not be a net operating loss carryback to any taxable year'', and

(B) by striking ''to each of the 20 taxable years'' in clause (ii) and inserting ''to each taxable year''.

(2) CONFORMING AMENDMENT.—Section 172(b)(1) is amended by striking subparagraphs (B) through (F).

(c) TREATMENT OF FARMING LOSSES.—

(1) ALLOWANCE OF CARRYBACKS.—Section 172(b)(1), as amended by subsection (b)(2), is amended by adding at the end the following new subparagraph:

''(B) FARMING LOSSES.—

''(i) IN GENERAL.—In the case of any portion of a net operating loss for the taxable year which is a farming loss with respect to the taxpayer, such loss shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss.

''(ii) FARMING LOSS.—For purposes of this section, the term 'farming loss' means the lesser of—

''(I) the amount which would be the net operating loss for the taxable year if only income and deductions attributable to farming businesses (as defined in section 263A(e)(4)) are taken into account, or

''(II) the amount of the net operating loss for such taxable year.

''(iii) COORDINATION WITH PARAGRAPH (2).—For purposes of applying paragraph (2), a farming loss for any taxable year shall be treated as a separate net operating loss for such taxable year to be taken into account after the remaining portion of the net operating loss for such taxable year.

''(iv) ELECTION.—Any taxpayer entitled to a 2-year carryback under clause (i) from any loss year may elect not to have such clause apply to such loss year. Such election shall be made in such manner as prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for such taxable year.''.

(2) CONFORMING AMENDMENTS.—

(A) Section 172 is amended by striking subsections (f), (g), and (h), and by redesignating subsection (i) as subsection (f).

(B) Section 537(b)(4) is amended by inserting ''(as in effect before the date of enactment of the Tax Cuts and Jobs Act)'' after ''as defined in section 172(f)''.

(d) TREATMENT OF CERTAIN INSURANCE LOSSES.—

(1) TREATMENT OF CARRYFORWARDS AND CARRYBACKS.—Section 172(b)(1), as amended by subsections (b)(2) and (c)(1), is amended by adding at the end the following new subparagraph:

''(C) INSURANCE COMPANIES.—In the case of an insurance company (as defined in section 816(a)) other than a life insurance company, the net operating loss for any taxable year—

''(i) shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and

''(ii) shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss.''.

(2) EXEMPTION FROM LIMITATION.—Section 172, as amended by subsection (c)(2)(A), is amended by redesignating subsection (f) as subsection (g) and inserting after subsection (e) the following new subsection:

''(f) SPECIAL RULE FOR INSURANCE COMPANIES.—In the case of an insurance company (as defined in section 816(a)) other than a life insurance company—

''(1) the amount of the deduction allowed under subsection (a) shall be the aggregate of the net operating loss carryovers to such year, plus the net operating loss carrybacks to such year, and

''(2) subparagraph (C) of subsection (b)(2) shall not apply.''.

(e) EFFECTIVE DATE.—

(1) NET OPERATING LOSS LIMITATION.—The amendments made by subsections (a) and (d)(2) shall apply to losses arising in taxable years beginning after December 31, 2017.

(2) CARRYFORWARDS AND CARRYBACKS.—The amendments made by subsections (b), (c), and (d)(1) shall apply to net operating losses arising in taxable years ending after December 31, 2017.

SEC. 13303. 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)(A) 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.''.

(B) Section 1031 is amended by striking subsection (i).

(2) Section 1031 is amended by striking subsection (e).

(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. 13304. LIMITATION ON DEDUCTION BY EMPLOYERS OF EXPENSES FOR FRINGE BENEFITS.

(a) NO DEDUCTION ALLOWED FOR ENTERTAINMENT EXPENSES.—

(1) IN GENERAL.—Section 274(a) is amended—

(A) in paragraph (1)(A), by striking ''unless'' and all that follows through ''trade or business,'',

(B) by striking the flush sentence at the end of paragraph (1), and

(C) by striking paragraph (2)(C).

(2) CONFORMING AMENDMENTS.—

(A) Section 274(d) is amended—

(i) by striking paragraph (2) and redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively, and

(ii) in the flush text following paragraph (3) (as so redesignated)—

(I) by striking '', entertainment, amusement, recreation, or use of the facility or property,'' 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'',

(B) Section 274 is amended by striking subsection (l).

(C) Section 274(n) is amended by striking ''AND ENTERTAINMENT'' in the heading.

(D) Section 274(n)(1) is amended to read as follows:

''(1) IN GENERAL.—The amount allowable as a deduction under this chapter for any expense for food or beverages shall not exceed 50 percent of the amount of such expense which would (but for this paragraph) be allowable as a deduction under this chapter.''.

(E) Section 274(n)(2) is amended—

(i) in subparagraph (B), by striking ''in the case of an expense for food or beverages,'',

(ii) by striking subparagraph (C) and redesignating subparagraphs (D) and (E) as subparagraphs (C) and (D), respectively,

(iii) by striking ''of subparagraph (E)'' the last sentence and inserting ''of subparagraph (D)'', and

(iv) by striking ''in subparagraph (D)'' in the last sentence and inserting ''in subparagraph (C)''.

(F) Clause (iv) of section 7701(b)(5)(A) is amended to read as follows:

''(iv) a professional athlete who is temporarily in the United States to compete in a sports event—

''(I) which is organized for the primary purpose of benefiting an organization which is described in section 501(c)(3) and exempt from tax under section 501(a),

''(II) all of the net proceeds of which are contributed to such organization, and,

''(III) which utilizes volunteers for substantially all of the work performed in carrying out such event.''.

(b) ONLY 50 PERCENT OF EXPENSES FOR MEALS PROVIDED ON OR NEAR BUSINESS PREMISES ALLOWED AS DEDUCTION.—Paragraph (2) of section 274(n), as amended by subsection (a), is amended—

(1) by striking subparagraph (B),

(2) by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively,

(3) by striking ''of subparagraph (D)'' in the last sentence and inserting ''of subparagraph (C)'', and

(4) by striking ''in subparagraph (C)'' in the last sentence and inserting ''in subparagraph (B)''.

(c) TREATMENT OF TRANSPORTATION BENEFITS.—Section 274, as amended by subsection (a), is amended—

(1) in subsection (a)—

(A) in the heading, by striking ''OR RECREATION'' and inserting ''RECREATION, OR QUALIFIED TRANSPORTATION FRINGES'', and

(B) by adding at the end the following new paragraph:

''(4) QUALIFIED TRANSPORTATION FRINGES.—No deduction shall be allowed under this chapter for the expense of any qualified transportation fringe (as defined in section 132(f)) provided to an employee of the taxpayer.'', and

(2) by inserting after subsection (k) the following new subsection:

''(l) TRANSPORTATION AND COMMUTING BENEFITS.—

''(1) IN GENERAL.—No deduction shall be allowed under this chapter for any expense incurred for providing any transportation, or any payment or reimbursement, to an employee of the taxpayer in connection with travel between the employee's residence and place of employment, except as necessary for ensuring the safety of the employee.

''(2) EXCEPTION.—In the case of any qualified bicycle commuting reimbursement (as described in section 132(f)(5)(F)), this subsection shall not apply for any amounts paid or incurred after December 31, 2017, and before January 1, 2026.''.

(d) ELIMINATION OF DEDUCTION FOR MEALS PROVIDED AT CONVENIENCE OF EMPLOYER.—Section 274, as amended by subsection (c), is amended—

(1) by redesignating subsection (o) as subsection (p), and

(2) by inserting after subsection (n) the following new subsection:

''(o) MEALS PROVIDED AT CONVENIENCE OF EMPLOYER.—No deduction shall be allowed under this chapter for—

''(1) any expense for the operation of a facility described in section 132(e)(2), and any expense for food or beverages, including under section 132(e)(1), associated with such facility, or

''(2) any expense for meals described in section 119(a).''.

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts incurred or paid after December 31, 2017.

(2) EFFECTIVE DATE FOR ELIMINATION OF DEDUCTION FOR MEALS PROVIDED AT CONVENIENCE OF EMPLOYER.—The amendments made by subsection (d) shall apply to amounts incurred or paid after December 31, 2025.

SEC. 13305. 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), 135(c)(4)(A), 137(b)(3)(A), 219(g)(3)(A)(ii), 221(b)(2)(C), 222(b)(2)(C), 246(b)(1), and 469(i)(3)(F)(iii) are each amended by striking ''199,''.

(2) Section 170(b)(2)(D), as amended by subtitle A, is amended by striking clause (iv), and by redesignating clauses (v) and (vi) as clauses (iv) and (v).

(3) Section 172(d) is amended by striking paragraph (7).

(4) Section 613(a), as amended by section 11011, is amended by striking ''and without the deduction under section 199''.

(5) Section 613A(d)(1), as amended by section 11011, is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), (E), and (F) as subparagraphs (B), (C), (D), and (E), respectively.

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

SEC. 13306. DENIAL OF DEDUCTION FOR CERTAIN FINES, PENALTIES, AND OTHER AMOUNTS.

(a) DENIAL OF DEDUCTION.—

(1) IN GENERAL.—Subsection (f) of section 162 is amended to read as follows:

''(f) FINES, PENALTIES, AND OTHER AMOUNTS.—

''(1) IN GENERAL.—Except as provided in the following paragraphs of this subsection, no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law.

''(2) EXCEPTION FOR AMOUNTS CONSTITUTING RESTITUTION OR PAID TO COME INTO COMPLIANCE WITH LAW.—

''(A) IN GENERAL.—Paragraph (1) shall not apply to any amount that—

''(i) the taxpayer establishes—

''(I) constitutes restitution (including remediation of property) for damage or harm which was or may be caused by the violation of any law or the potential violation of any law, or

''(II) is paid to come into compliance with any law which was violated or otherwise involved in the investigation or inquiry described in paragraph (1),

''(ii) is identified as restitution or as an amount paid to come into compliance with such law, as the case may be, in the court order or settlement agreement, and

''(iii) in the case of any amount of restitution for failure to pay any tax imposed under this title in the same manner as if such amount were such tax, would have been allowed as a deduction under this chapter if it had been timely paid.

The identification under clause (ii) alone shall not be sufficient to make the establishment required under clause (i).

''(B) LIMITATION.—Subparagraph (A) shall not apply to any amount paid or incurred as reimbursement to the government or entity for the costs of any investigation or litigation.

''(3) EXCEPTION FOR AMOUNTS PAID OR INCURRED AS THE RESULT OF CERTAIN COURT ORDERS.—Paragraph (1) shall not apply to any amount paid or incurred by reason of any order of a court in a suit in which no government or governmental entity is a party.

''(4) EXCEPTION FOR TAXES DUE.—Paragraph (1) shall not apply to any amount paid or incurred as taxes due.

''(5) TREATMENT OF CERTAIN NONGOVERNMENTAL REGULATORY ENTITIES.—For purposes of this subsection, the following nongovernmental entities shall be treated as governmental entities:

''(A) Any nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) in connection with a qualified board or exchange (as defined in section 1256(g)(7)).

''(B) To the extent provided in regulations, any nongovernmental entity which exercises self-regulatory powers (including imposing sanctions) as part of performing an essential governmental function.''.

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to amounts paid or incurred on or after the date of the enactment of this Act, except that such amendments shall not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception shall not apply to an order or agreement requiring court approval unless the approval was obtained before such date.

(b) REPORTING OF DEDUCTIBLE AMOUNTS.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 is amended by inserting after section 6050W the following new section:

''SEC. 6050X. INFORMATION WITH RESPECT TO CERTAIN FINES, PENALTIES, AND OTHER AMOUNTS.

''(a) REQUIREMENT OF REPORTING.—

''(1) IN GENERAL.—The appropriate official of any government or any entity described in section 162(f)(5) which is involved in a suit or agreement described in paragraph (2) shall make a return in such form as determined by the Secretary setting forth—

''(A) the amount required to be paid as a result of the suit or agreement to which paragraph (1) of section 162(f) applies,

''(B) any amount required to be paid as a result of the suit or agreement which constitutes restitution or remediation of property, and

''(C) any amount required to be paid as a result of the suit or agreement for the purpose of coming into compliance with any law which was violated or involved in the investigation or inquiry.

''(2) SUIT OR AGREEMENT DESCRIBED.—

''(A) IN GENERAL.—A suit or agreement is described in this paragraph if—

''(i) it is—

''(I) a suit with respect to a violation of any law over which the government or entity has authority and with respect to which there has been a court order, or

''(II) an agreement which is entered into with respect to a violation of any law over which the government or entity has authority, or with respect to an investigation or inquiry by the government or entity into the potential violation of any law over which such government or entity has authority, and

''(ii) the aggregate amount involved in all court orders and agreements with respect to the violation, investigation, or inquiry is $600 or more.

''(B) ADJUSTMENT OF REPORTING THRESHOLD.—The Secretary shall adjust the $600 amount in subparagraph (A)(ii) as necessary in order to ensure the efficient administration of the internal revenue laws.

''(3) TIME OF FILING.—The return required under this subsection shall be filed at the time the agreement is entered into, as determined by the Secretary.

''(b) STATEMENTS TO BE FURNISHED TO INDIVIDUALS INVOLVED IN THE SETTLEMENT.—Every person required to make a return under subsection (a) shall furnish to each person who is a party to the suit or agreement a written statement showing—

''(1) the name of the government or entity, and

''(2) the information supplied to the Secretary under subsection (a)(1).

The written statement required under the preceding sentence shall be furnished to the person at the same time the government or entity provides the Secretary with the information required under subsection (a).

''(c) APPROPRIATE OFFICIAL DEFINED.—For purposes of this section, the term 'appropriate official' means the officer or employee having control of the suit, investigation, or inquiry or the person appropriately designated for purposes of this section.''.

(2) CONFORMING AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6050W the following new item:

''Sec. 6050X. Information with respect to certain fines, penalties, and other amounts.''.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts paid or incurred on or after the date of the enactment of this Act, except that such amendments shall not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception shall not apply to an order or agreement requiring court approval unless the approval was obtained before such date.

SEC. 13307. DENIAL OF DEDUCTION FOR SETTLEMENTS SUBJECT TO NONDISCLOSURE AGREEMENTS PAID IN CONNECTION WITH SEXUAL HARASSMENT OR SEXUAL ABUSE.

(a) DENIAL OF DEDUCTION.—Section 162 is amended by redesignating subsection (q) as subsection (r) and by inserting after subsection (p) the following new subsection:

''(q) PAYMENTS RELATED TO SEXUAL HARASSMENT AND SEXUAL ABUSE.—No deduction shall be allowed under this chapter for—

''(1) any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or

''(2) attorney's fees related to such a settlement or payment.''.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after the date of the enactment of this Act.

SEC. 13308. 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 on or after the date of the enactment of this Act.

SEC. 13309. 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, notwithstanding section 83 or any election in effect under section 83(b).

''(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) 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:

''Sec. 1061. Partnership interests held in connection with performance of services.

''Sec. 1062. Cross references.''.

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

SEC. 13310. PROHIBITION ON CASH, GIFT CARDS, AND OTHER NON-TANGIBLE PERSONAL PROPERTY AS EMPLOYEE ACHIEVEMENT AWARDS.

(a) IN GENERAL.—Subparagraph (A) of section 274(j)(3) is amended—

(1) by striking ''The term'' and inserting the following:

''(i) IN GENERAL.—The term''.

(2) by redesignating clauses (i), (ii), and (iii) as subclauses (I), (II), and (III), respectively, and conforming the margins accordingly, and

(3) by adding at the end the following new clause:

''(ii) TANGIBLE PERSONAL PROPERTY.—For purposes of clause (i), the term 'tangible personal property' shall not include—

''(I) cash, cash equivalents, gift cards, gift coupons, or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or

''(II) vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items.''.

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

SEC. 13311. ELIMINATION OF DEDUCTION FOR LIVING EXPENSES INCURRED BY MEMBERS OF CONGRESS.

(a) IN GENERAL.—Subsection (a) of section 162 is amended in the matter following paragraph (3) by striking ''in excess of $3,000''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 13312. CERTAIN CONTRIBUTIONS BY GOVERNMENTAL ENTITIES NOT TREATED AS CONTRIBUTIONS TO CAPITAL.

(a) IN GENERAL.—Section 118 is amended—

(1) by striking subsections (b), (c), and (d),

(2) by redesignating subsection (e) as subsection (d), and

(3) by inserting after subsection (a) the following new subsections:

''(b) EXCEPTIONS.—For purposes of subsection (a), the term 'contribution to the capital of the taxpayer' does not include—

''(1) any contribution in aid of construction or any other contribution as a customer or potential customer, and

''(2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such).

''(c) REGULATIONS.—The Secretary shall issue such regulations or other guidance as may be necessary or appropriate to carry out this section, including regulations or other guidance for determining whether any contribution constitutes a contribution in aid of construction.''.

(b) EFFECTIVE DATE.—

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

(2) EXCEPTION.—The amendments made by this section shall not apply to any contribution, made after the date of enactment of this Act by a governmental entity, which is made pursuant to a master development plan that has been approved prior to such date by a governmental entity.

SEC. 13313. 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. 13314. 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.

PART V—BUSINESS CREDITS

SEC. 13401. MODIFICATION OF ORPHAN DRUG CREDIT.

(a) CREDIT RATE.—Subsection (a) of section 45C is amended by striking ''50 percent'' and inserting ''25 percent''.

(b) ELECTION OF REDUCED CREDIT.—Subsection (b) of section 280C is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

''(3) ELECTION OF REDUCED CREDIT.—

''(A) IN GENERAL.—In the case of any taxable year for which an election is made under this paragraph—

''(i) paragraphs (1) and (2) shall not apply, and

''(ii) the amount of the credit under section 45C(a) shall be the amount determined under subparagraph (B).

''(B) AMOUNT OF REDUCED CREDIT.—The amount of credit determined under this subparagraph for any taxable year shall be the amount equal to the excess of—

''(i) the amount of credit determined under section 45C(a) without regard to this paragraph, over

''(ii) the product of—

''(I) the amount described in clause (i), and

''(II) the maximum rate of tax under section 11(b).

''(C) ELECTION.—An election under this paragraph for any taxable year shall be made not later than the time for filing the return of tax for such year (including extensions), shall be made on such return, and shall be made in such manner as the Secretary shall prescribe. Such an election, once made, shall be irrevocable.''.

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

SEC. 13402. REHABILITATION CREDIT LIMITED TO CERTIFIED HISTORIC STRUCTURES.

(a) IN GENERAL.—Subsection (a) of section 47 is amended to read as follows:

''(a) GENERAL RULE.—

''(1) IN GENERAL.—For purposes of section 46, for any taxable year during the 5-year period beginning in the taxable year in which a qualified rehabilitated building is placed in service, the rehabilitation credit for such year is an amount equal to the ratable share for such year.

''(2) RATABLE SHARE.—For purposes of paragraph (1), the ratable share for any taxable year during the period described in such paragraph is the amount equal to 20 percent of the qualified rehabilitation expenditures with respect to the qualified rehabilitated building, as allocated ratably to each year during such period.''.

(b) CONFORMING AMENDMENTS.—

(1) Section 47(c) is amended—

(A) in paragraph (1)—

(i) in subparagraph (A), by amending clause (iii) to read as follows:

''(iii) such building is a certified historic structure, and'',

(ii) by striking subparagraph (B), and

(iii) by redesignating subparagraphs (C) and (D) as subparagraphs (B) and (C), respectively, and

(B) in paragraph (2)(B), by amending clause (iv) to read as follows:

''(iv) CERTIFIED HISTORIC STRUCTURE.—Any expenditure attributable to the rehabilitation of a qualified rehabilitated building unless the rehabilitation is a certified rehabilitation (within the meaning of subparagraph (C)).''.

(2) Paragraph (4) of section 145(d) is amended—

(A) by striking ''of section 47(c)(1)(C)'' each place it appears and inserting ''of section 47(c)(1)(B)'', and

(B) by striking ''section 47(c)(1)(C)(i)'' and inserting ''section 47(c)(1)(B)(i)''.

(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 with respect to any building—

(A) owned or leased by the taxpayer during the entirety of the period after December 31, 2017, and

(B) with respect to which the 24-month period selected by the taxpayer under clause (i) of section 47(c)(1)(B) of the Internal Revenue Code (as amended by subsection (b)), or the 60-month period applicable under clause (ii) of such section, begins not later than 180 days after 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, or the 60-month period, referred to in subparagraph (B) ends.

SEC. 13403. EMPLOYER CREDIT FOR PAID FAMILY AND MEDICAL LEAVE.

(a) IN GENERAL.—

(1) ALLOWANCE OF CREDIT.—Subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following new section:

''SEC. 45S. EMPLOYER CREDIT FOR PAID FAMILY AND MEDICAL LEAVE.

''(a) ESTABLISHMENT OF CREDIT.—

''(1) IN GENERAL.—For purposes of section 38, in the case of an eligible employer, the paid family and medical leave credit is an amount equal to the applicable percentage of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave.

''(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term 'applicable percentage' means 12.5 percent increased (but not above 25 percent) by 0.25 percentage points for each percentage point by which the rate of payment (as described under subsection (c)(1)(B)) exceeds 50 percent.

''(b) LIMITATION.—

''(1) IN GENERAL.—The credit allowed under subsection (a) with respect to any employee for any taxable year shall not exceed an amount equal to the product of the normal hourly wage rate of such employee for each hour (or fraction thereof) of actual services performed for the employer and the number of hours (or fraction thereof) for which family and medical leave is taken.

''(2) NON-HOURLY WAGE RATE.—For purposes of paragraph (1), in the case of any employee who is not paid on an hourly wage rate, the wages of such employee shall be prorated to an hourly wage rate under regulations established by the Secretary.

''(3) MAXIMUM AMOUNT OF LEAVE SUBJECT TO CREDIT.—The amount of family and medical leave that may be taken into account with respect to any employee under subsection (a) for any taxable year shall not exceed 12 weeks.

''(c) ELIGIBLE EMPLOYER.—For purposes of this section—

''(1) IN GENERAL.—The term 'eligible employer' means any employer who has in place a written policy that meets the following requirements:

''(A) The policy provides—

''(i) in the case of a qualifying employee who is not a part-time employee (as defined in section 4980E(d)(4)(B)), not less than 2 weeks of annual paid family and medical leave, and

''(ii) in the case of a qualifying employee who is a part-time employee, an amount of annual paid family and medical leave that is not less than an amount which bears the same ratio to the amount of annual paid family and medical leave that is provided to a qualifying employee described in clause (i) as—

''(I) the number of hours the employee is expected to work during any week, bears to

''(II) the number of hours an equivalent qualifying employee described in clause (i) is expected to work during the week.

''(B) The policy requires that the rate of payment under the program is not less than 50 percent of the wages normally paid to such employee for services performed for the employer.

''(2) SPECIAL RULE FOR CERTAIN EMPLOYERS.—

''(A) IN GENERAL.—An added employer shall not be treated as an eligible employer unless such employer provides paid family and medical leave in compliance with a written policy which ensures that the employer—

''(i) will not interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided under the policy, and

''(ii) will not discharge or in any other manner discriminate against any individual for opposing any practice prohibited by the policy.

''(B) ADDED EMPLOYER; ADDED EMPLOYEE.—For purposes of this paragraph—

''(i) ADDED EMPLOYEE.—The term 'added employee' means a qualifying employee who is not covered by title I of the Family and Medical Leave Act of 1993, as amended.

''(ii) ADDED EMPLOYER.—The term 'added employer' means an eligible employer (determined without regard to this paragraph), whether or not covered by that title I, who offers paid family and medical leave to added employees.

''(3) AGGREGATION RULE.—All persons which are treated as a single employer under subsections (a) and (b) of section 52 shall be treated as a single taxpayer.

''(4) TREATMENT OF BENEFITS MANDATED OR PAID FOR BY STATE OR LOCAL GOVERNMENTS.—For purposes of this section, any leave which is paid by a State or local government or required by State or local law shall not be taken into account in determining the amount of paid family and medical leave provided by the employer.

''(5) NO INFERENCE.—Nothing in this subsection shall be construed as subjecting an employer to any penalty, liability, or other consequence (other than ineligibility for the credit allowed by reason of subsection (a) or recapturing the benefit of such credit) for failure to comply with the requirements of this subsection.

''(d) QUALIFYING EMPLOYEES.—For purposes of this section, the term 'qualifying employee' means any employee (as defined in section 3(e) of the Fair Labor Standards Act of 1938, as amended) who—

''(1) has been employed by the employer for 1 year or more, and

''(2) for the preceding year, had compensation not in excess of an amount equal to 60 percent of the amount applicable for such year under clause (i) of section 414(q)(1)(B).

''(e) FAMILY AND MEDICAL LEAVE.—

''(1) IN GENERAL.—Except as provided in paragraph (2), for purposes of this section, the term 'family and medical leave' means leave for any 1 or more of the purposes described under subparagraph (A), (B), (C), (D), or (E) of paragraph (1), or paragraph (3), of section 102(a) of the Family and Medical Leave Act of 1993, as amended, whether the leave is provided under that Act or by a policy of the employer.

''(2) EXCLUSION.—If an employer provides paid leave as vacation leave, personal leave, or medical or sick leave (other than leave specifically for 1 or more of the purposes referred to in paragraph (1)), that paid leave shall not be considered to be family and medical leave under paragraph (1).

''(3) DEFINITIONS.—In this subsection, the terms 'vacation leave', 'personal leave', and 'medical or sick leave' mean those 3 types of leave, within the meaning of section 102(d)(2) of that Act.

''(f) DETERMINATIONS MADE BY SECRETARY OF TREASURY.—For purposes of this section, any determination as to whether an employer or an employee satisfies the applicable requirements for an eligible employer (as described in subsection (c)) or qualifying employee (as described in subsection (d)), respectively, shall be made by the Secretary based on such information, to be provided by the employer, as the Secretary determines to be necessary or appropriate.

''(g) WAGES.—For purposes of this section, the term 'wages' has the meaning given such term by subsection (b) of section 3306 (determined without regard to any dollar limitation contained in such section). Such term shall not include any amount taken into account for purposes of determining any other credit allowed under this subpart.

''(h) ELECTION TO HAVE CREDIT NOT APPLY.—

''(1) IN GENERAL.—A taxpayer may elect to have this section not apply for any taxable year.

''(2) OTHER RULES.—Rules similar to the rules of paragraphs (2) and (3) of section 51(j) shall apply for purposes of this subsection.

''(i) TERMINATION.—This section shall not apply to wages paid in taxable years beginning after December 31, 2019.''.

(b) CREDIT PART OF GENERAL BUSINESS CREDIT.—Section 38(b) is amended by striking ''plus'' at the end of paragraph (35), by striking the period at the end of paragraph (36) and inserting '', plus'', and by adding at the end the following new paragraph:

''(37) in the case of an eligible employer (as defined in section 45S(c)), the paid family and medical leave credit determined under section 45S(a).''.

(c) CREDIT ALLOWED AGAINST AMT.—Subparagraph (B) of section 38(c)(4) is amended by redesignating clauses (ix) through (xi) as clauses (x) through (xii), respectively, and by inserting after clause (viii) the following new clause:

''(ix) the credit determined under section 45S,''.

(d) CONFORMING AMENDMENTS.—

(1) DENIAL OF DOUBLE BENEFIT.—Section 280C(a) is amended by inserting ''45S(a),'' after ''45P(a),''.

(2) ELECTION TO HAVE CREDIT NOT APPLY.—Section 6501(m) is amended by inserting ''45S(h),'' after ''45H(g),''.

(3) CLERICAL AMENDMENT.—The table of sections for subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following new item:

''Sec. 45S. Employer credit for paid family and medical leave.''.

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

SEC. 13404. 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.

PART VI—PROVISIONS RELATED TO SPECIFIC ENTITIES AND INDUSTRIES

Subpart A—Partnership Provisions

SEC. 13501. TREATMENT OF GAIN OR LOSS OF FOREIGN PERSONS FROM SALE OR EXCHANGE OF INTERESTS IN PARTNERSHIPS ENGAGED IN TRADE OR BUSINESS WITHIN THE UNITED STATES.

(a) AMOUNT TREATED AS EFFECTIVELY CONNECTED.—

(1) IN GENERAL.—Section 864(c) is amended by adding at the end the following:

''(8) GAIN OR LOSS OF FOREIGN PERSONS FROM SALE OR EXCHANGE OF CERTAIN PARTNERSHIP INTERESTS.—

''(A) IN GENERAL.—Notwithstanding any other provision of this subtitle, if a nonresident alien individual or foreign corporation owns, directly or indirectly, an interest in a partnership which is engaged in any trade or business within the United States, gain or loss on the sale or exchange of all (or any portion of) such interest shall be treated as effectively connected with the conduct of such trade or business to the extent such gain or loss does not exceed the amount determined under subparagraph (B).

''(B) AMOUNT TREATED AS EFFECTIVELY CONNECTED.—The amount determined under this subparagraph with respect to any partnership interest sold or exchanged—

''(i) in the case of any gain on the sale or exchange of the partnership interest, is—

''(I) the portion of the partner's distributive share of the amount of gain which would have been effectively connected with the conduct of a trade or business within the United States if the partnership had sold all of its assets at their fair market value as of the date of the sale or exchange of such interest, or

''(II) zero if no gain on such deemed sale would have been so effectively connected, and

''(ii) in the case of any loss on the sale or exchange of the partnership interest, is—

''(I) the portion of the partner's distributive share of the amount of loss on the deemed sale described in clause (i)(I) which would have been so effectively connected, or

''(II) zero if no loss on such deemed sale would be have been so effectively connected.

For purposes of this subparagraph, a partner's distributive share of gain or loss on the deemed sale shall be determined in the same manner as such partner's distributive share of the non-separately stated taxable income or loss of such partnership.

''(C) COORDINATION WITH UNITED STATES REAL PROPERTY INTERESTS.—If a partnership described in subparagraph (A) holds any United States real property interest (as defined in section 897(c)) at the time of the sale or exchange of the partnership interest, then the gain or loss treated as effectively connected income under subparagraph (A) shall be reduced by the amount so treated with respect to such United States real property interest under section 897.

''(D) SALE OR EXCHANGE.—For purposes of this paragraph, the term 'sale or exchange' means any sale, exchange, or other disposition.

''(E) SECRETARIAL AUTHORITY.—The Secretary shall prescribe such regulations or other guidance as the Secretary determines appropriate for the application of this paragraph, including with respect to exchanges described in section 332, 351, 354, 355, 356, or 361.''.

(2) CONFORMING AMENDMENTS.—Section 864(c)(1) is amended—

(A) by striking ''and (7)'' in subparagraph (A), and inserting ''(7), and (8)'', and

(B) by striking ''or (7)'' in subparagraph (B), and inserting ''(7), or (8)''.

(b) WITHHOLDING REQUIREMENTS.—Section 1446 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following:

''(f) SPECIAL RULES FOR WITHHOLDING ON DISPOSITIONS OF PARTNERSHIP INTERESTS.—

''(1) IN GENERAL.—Except as provided in this subsection, if any portion of the gain (if any) on any disposition of an interest in a partnership would be treated under section 864(c)(8) as effectively connected with the conduct of a trade or business within the United States, the transferee shall be required to deduct and withhold a tax equal to 10 percent of the amount realized on the disposition.

''(2) EXCEPTION IF NONFOREIGN AFFIDAVIT FURNISHED.—

''(A) IN GENERAL.—No person shall be required to deduct and withhold any amount under paragraph (1) with respect to any disposition if the transferor furnishes to the transferee an affidavit by the transferor stating, under penalty of perjury, the transferor's United States taxpayer identification number and that the transferor is not a foreign person.

''(B) FALSE AFFIDAVIT.—Subparagraph (A) shall not apply to any disposition if—

''(i) the transferee has actual knowledge that the affidavit is false, or the transferee receives a notice (as described in section 1445(d)) from a transferor's agent or transferee's agent that such affidavit or statement is false, or

''(ii) the Secretary by regulations requires the transferee to furnish a copy of such affidavit or statement to the Secretary and the transferee fails to furnish a copy of such affidavit or statement to the Secretary at such time and in such manner as required by such regulations.

''(C) RULES FOR AGENTS.—The rules of section 1445(d) shall apply to a transferor's agent or transferee's agent with respect to any affidavit described in subparagraph (A) in the same manner as such rules apply with respect to the disposition of a United States real property interest under such section.

''(3) AUTHORITY OF SECRETARY TO PRESCRIBE REDUCED AMOUNT.—At the request of the transferor or transferee, the Secretary may prescribe a reduced amount to be withheld under this section if the Secretary determines that to substitute such reduced amount will not jeopardize the collection of the tax imposed under this title with respect to gain treated under section 864(c)(8) as effectively connected with the conduct of a trade or business with in the United States.

''(4) PARTNERSHIP TO WITHHOLD AMOUNTS NOT WITHHELD BY THE TRANSFEREE.—If a transferee fails to withhold any amount required to be withheld under paragraph (1), the partnership shall be required to deduct and withhold from distributions to the transferee a tax in an amount equal to the amount the transferee failed to withhold (plus interest under this title on such amount).

''(5) DEFINITIONS.—Any term used in this subsection which is also used under section 1445 shall have the same meaning as when used in such section.

''(6) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary to carry out the purposes of this subsection, including regulations providing for exceptions from the provisions of this subsection.''.

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendments made by subsection (a) shall apply to sales, exchanges, and dispositions on or after November 27, 2017.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to sales, exchanges, and dispositions after December 31, 2017.

SEC. 13502. MODIFY DEFINITION OF SUBSTANTIAL BUILT-IN LOSS IN THE CASE OF TRANSFER OF PARTNERSHIP INTEREST.

(a) IN GENERAL.—Paragraph (1) of section 743(d) is to read as follows:

''(1) IN GENERAL.—For purposes of this section, a partnership has a substantial built-in loss with respect to a transfer of an interest in the partnership if—

''(A) the partnership's adjusted basis in the partnership property exceeds by more than $250,000 the fair market value of such property, or

''(B) the transferee partner would be allocated a loss of more than $250,000 if the partnership assets were sold for cash equal to their fair market value immediately after such transfer.''.

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

SEC. 13503. CHARITABLE CONTRIBUTIONS AND FOREIGN TAXES TAKEN INTO ACCOUNT IN DETERMINING LIMITATION ON ALLOWANCE OF PARTNER'S SHARE OF LOSS.

(a) IN GENERAL.—Subsection (d) of section 704 is amended—

(1) by striking ''A partner's distributive share'' and inserting the following:

''(1) IN GENERAL.—A partner's distributive share'',

(2) by striking ''Any excess of such loss'' and inserting the following:

''(2) CARRYOVER.—Any excess of such loss'', and

(3) by adding at the end the following new paragraph:

''(3) SPECIAL RULES.—

''(A) IN GENERAL.—In determining the amount of any loss under paragraph (1), there shall be taken into account the partner's distributive share of amounts described in paragraphs (4) and (6) of section 702(a).

''(B) EXCEPTION.—In the case of a charitable contribution of property whose fair market value exceeds its adjusted basis, subparagraph (A) shall not apply to the extent of the partner's distributive share of such excess.''.

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

SEC. 13504. 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) CONFORMING AMENDMENT.—

(1) Section 168(i)(7)(B) is amended by striking the second sentence.

(2) Section 743(e) is amended by striking paragraph (4) and redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6).

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

Subpart B—Insurance Reforms

SEC. 13511. 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)(A) 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).

(B) Section 831(b)(3) is amended by striking ''except as provided in section 844,''

(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 805(b)(2)(A)(iv) is amended to read as follows:

''(iv) any net operating loss carryback to the taxable year under section 172, and''.

(7) 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.''.

(8) Section 1351(i)(3) is amended by striking ''or the operations loss deduction under section 810,''.

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

SEC. 13512. 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 this Act, 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), as amended by this Act, 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 13511, 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. 13513. 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. 13514. 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. 13515. MODIFICATION OF PRORATION RULES FOR PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) IN GENERAL.—Section 832(b)(5)(B) is amended—

(1) by striking ''15 percent'' and inserting ''the applicable percentage'', and

(2) by inserting at the end the following new sentence: ''For purposes of this subparagraph, the applicable percentage is 5.25 percent divided by the highest rate in effect under section 11(b).''.

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

SEC. 13516. 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.

SEC. 13517. COMPUTATION OF LIFE INSURANCE TAX RESERVES.

(a) IN GENERAL.—

(1) APPROPRIATE RATE OF INTEREST.—The second sentence of section 807(c) is amended to read as follows: ''For purposes of paragraph (3), the appropriate rate of interest is the highest rate or rates permitted to be used to discount the obligations by the National Association of Insurance Commissioners as of the date the reserve is determined.''.

(2) METHOD OF COMPUTING RESERVES.—Section 807(d) is amended—

(A) by striking paragraphs (1), (2), (4), and (5),

(B) by redesignating paragraph (6) as paragraph (4),

(C) by inserting before paragraph (3) the following new paragraphs:

''(1) DETERMINATION OF RESERVE.—

''(A) IN GENERAL.—For purposes of this part (other than section 816), the amount of the life insurance reserves for any contract (other than a contract to which subparagraph (B) applies) shall be the greater of—

''(i) the net surrender value of such contract, or

''(ii) 92.81 percent of the reserve determined under paragraph (2).

''(B) VARIABLE CONTRACTS.—For purposes of this part (other than section 816), the amount of the life insurance reserves for a variable contract shall be equal to the sum of—

''(i) the greater of—

''(I) the net surrender value of such contract, or

''(II) the portion of the reserve that is separately accounted for under section 817, plus

''(ii) 92.81 percent of the excess (if any) of the reserve determined under paragraph (2) over the amount in clause (i).

''(C) STATUTORY CAP.—In no event shall the reserves determined under subparagraphs (A) or (B) for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining statutory reserves (as defined in paragraph (4)).

''(D) NO DOUBLE COUNTING.—In no event shall any amount or item be taken into account more than once in determining any reserve under this subchapter.

''(2) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined by *using the tax reserve method applicable to such contract.''.*

(D) by striking ''(other than a qualified long-term care insurance contract, as defined in section 7702B(b)), a 2-year full preliminary term method'' in paragraph (3)(A)(iii) and inserting '', the reserve method prescribed by the National Association of Insurance Commissioners which covers such contract as of the date the reserve is determined'',

(E) by striking ''(as of the date of issuance)'' in paragraph (3)(A)(iv)(I) and inserting ''(as of the date the reserve is determined)'',

(F) by striking ''as of the date of the issuance of'' in paragraph (3)(A)(iv)(II) and inserting ''as of the date the reserve is determined for'',

(G) by striking ''in effect on the date of the issuance of the contract'' in paragraph (3)(B)(i) and inserting ''applicable to the contract and in effect as of the date the reserve is determined'', and

(H) by striking ''in effect on the date of the issuance of the contract'' in paragraph (3)(B)(ii) and inserting ''applicable to the contract and in effect as of the date the reserve is determined''.

(3) SPECIAL RULES.—Section 807(e) is amended—

(A) by striking paragraphs (2) and (5),

(B) by redesignating paragraphs (3), (4), (6), and (7) as paragraphs (2), (3), (4), and (5), respectively,

(C) by amending paragraph (2) (as so redesignated) to read as follows:

''(2) QUALIFIED SUPPLEMENTAL BENEFITS.—

''(A) QUALIFIED SUPPLEMENTAL BENEFITS TREATED SEPARATELY.—For purposes of this part, the amount of the life insurance reserve for any qualified supplemental benefit shall be computed separately as though such benefit were under a separate contract.

''(B) QUALIFIED SUPPLEMENTAL BENEFIT.—For purposes of this paragraph, the term 'qualified supplemental benefit' means any supplemental benefit described in subparagraph (C) if—

''(i) there is a separately identified premium or charge for such benefit, and

''(ii) any net surrender value under the contract attributable to any other benefit is not available to fund such benefit.

''(C) SUPPLEMENTAL BENEFITS.—For purposes of this paragraph, the supplemental benefits described in this subparagraph are any—

''(i) guaranteed insurability,

''(ii) accidental death or disability benefit,

''(iii) convertibility,

''(iv) disability waiver benefit, or

''(v) other benefit prescribed by regulations, which is supplemental to a contract for which there is a reserve described in subsection (c).'', and

(D) by adding at the end the following new paragraph:

''(6) REPORTING RULES.—The Secretary shall require reporting (at such time and in such manner as the Secretary shall prescribe) with respect to the opening balance and closing balance of reserves and with respect to the method of computing reserves for purposes of determining income.''.

(4) DEFINITION OF LIFE INSURANCE CONTRACT.—Section 7702 is amended—

(A) by striking clause (i) of subsection (c)(3)(B) and inserting the following:

''(i) reasonable mortality charges which meet the requirements prescribed in regulations to be promulgated by the Secretary or that do not exceed the mortality charges specified in the prevailing commissioners' standard tables as defined in subsection (f)(10),'' and

(B) by adding at the end of subsection (f) the following new paragraph:

''(10) PREVAILING COMMISSIONERS' STANDARD TABLES.—For purposes of subsection (c)(3)(B)(i), the term 'prevailing commissioners' standard tables' means the most recent commissioners' standard tables prescribed by the National Association of Insurance Commissioners which are permitted to be used in computing reserves for that type of contract under the insurance laws of at least 26 States when the contract was issued. If the prevailing commissioners' standard tables as of the beginning of any calendar year (hereinafter in this paragraph referred to as the 'year of change') are different from the prevailing commissioners' standard tables as of the beginning of the preceding calendar year, the issuer may use the prevailing commissioners' standard tables as of the beginning of the preceding calendar year with respect to any contract issued after the change and before the close of the 3-year period beginning on the first day of the year of change.''.

(b) CONFORMING AMENDMENTS.—

(1) Section 808 is amended by adding at the end the following new subsection:

''(g) PREVAILING STATE ASSUMED INTEREST RATE.—For purposes of this subchapter—

''(1) IN GENERAL.—The term 'prevailing State assumed interest rate' means, with respect to any contract, the highest assumed interest rate permitted to be used in computing life insurance reserves for insurance contracts or annuity contracts (as the case may be) under the insurance laws of at least 26 States. For purposes of the preceding sentence, the effect of nonforfeiture laws of a State on interest rates for reserves shall not be taken into account.

''(2) WHEN RATE DETERMINED.—The prevailing State assumed interest rate with respect to any contract shall be determined as of the beginning of the calendar year in which the contract was issued.''.

(2) Paragraph (1) of section 811(d) is amended by striking ''the greater of the prevailing State assumed interest rate or applicable Federal interest rate in effect under section 807'' and inserting ''the interest rate in effect under section 808(g)''.

(3) Subparagraph (A) of section 846(f)(6) is amended by striking ''except that'' and all that follows and inserting ''except that the limitation of subsection (a)(3) shall apply, and''.

(4) Section 848(e)(1)(B)(iii) is amended by striking ''807(e)(4)'' and inserting ''807(e)(3)''.

(5) Subparagraph (B) of section 954(i)(5) is amended by striking ''shall be substituted for the prevailing State assumed interest rate,'' and inserting ''shall apply,''.

(c) EFFECTIVE DATE.—

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

(2) TRANSITION RULE.—For the first taxable year beginning after December 31, 2017, the reserve with respect to any contract (as determined under section 807(d) of the Internal Revenue Code of 1986) at the end of the preceding taxable year shall be determined as if the amendments made by this section had applied to such reserve in such preceding taxable year.

(3) TRANSITION RELIEF.—

(A) IN GENERAL.—If—

(i) the reserve determined under section 807(d) of the Internal Revenue Code of 1986 (determined after application of paragraph (2)) with respect to any contract as of the close of the year preceding the first taxable year beginning after December 31, 2017, differs from

(ii) the reserve which would have been determined with respect to such contract as of the close of such taxable year under such section determined without regard to paragraph (2),

then the difference between the amount of the reserve described in clause (i) and the amount of the reserve described in clause (ii) shall be taken into account under the method provided in subparagraph (B).

(B) METHOD.—The method provided in this subparagraph is as follows:

(i) If the amount determined under subparagraph (A)(i) exceeds the amount determined under subparagraph (A)(ii), 1/8 of such excess shall be taken into account, for each of the 8 succeeding taxable years, as a deduction under section 805(a)(2) or 832(c)(4) of such Code, as applicable.

(ii) If the amount determined under subparagraph (A)(ii) exceeds the amount determined under subparagraph (A)(i), 1/8 of such excess shall be included in gross income, for each of the 8 succeeding taxable years, under section 803(a)(2) or 832(b)(1)(C) of such Code, as applicable.

SEC. 13518. MODIFICATION OF RULES FOR LIFE INSURANCE PRORATION FOR PURPOSES OF DETERMINING THE DIVIDENDS RECEIVED DEDUCTION.

(a) IN GENERAL.—Section 812 is amended to read as follows:

''SEC. 812. DEFINITION OF COMPANY'S SHARE AND POLICYHOLDER'S SHARE.

''(a) COMPANY'S SHARE.—For purposes of section 805(a)(4), the term 'company's share' means, with respect to any taxable year beginning after December 31, 2017, 70 percent.

''(b) POLICYHOLDER'S SHARE.—For purposes of section 807, the term 'policyholder's share' means, with respect to any taxable year beginning after December 31, 2017, 30 percent.''.

(b) CONFORMING AMENDMENT.—Section 817A(e)(2) is amended by striking '', 807(d)(2)(B), and 812'' and inserting ''and 807(d)(2)(B)''.

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

SEC. 13519. CAPITALIZATION OF CERTAIN POLICY ACQUISITION EXPENSES.

(a) IN GENERAL.—

(1) Section 848(a)(2) is amended by striking ''120-month'' and inserting ''180-month''.

(2) Section 848(c)(1) is amended by striking ''1.75 percent'' and inserting ''2.09 percent''.

(3) Section 848(c)(2) is amended by striking ''2.05 percent'' and inserting ''2.45 percent''.

(4) Section 848(c)(3) is amended by striking ''7.7 percent'' and inserting ''9.2 percent''.

(b) CONFORMING AMENDMENTS.—Section 848(b)(1) is amended by striking ''120-month'' and inserting ''180-month''.

(c) EFFECTIVE DATE.—

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

(2) TRANSITION RULE.—Specified policy acquisition expenses first required to be capitalized in a taxable year beginning before January 1, 2018, will continue to be allowed as a deduction ratably over the 120-month period beginning with the first month in the second half of such taxable year.

SEC. 13520. TAX REPORTING FOR LIFE SETTLEMENT TRANSACTIONS.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61, as amended by section 13306, is amended by adding at the end the following new section:

''SEC. 6050Y. RETURNS RELATING TO CERTAIN LIFE INSURANCE CONTRACT TRANSACTIONS.

''(a) REQUIREMENT OF REPORTING OF CERTAIN PAYMENTS.—

''(1) IN GENERAL.—Every person who acquires a life insurance contract or any interest in a life insurance contract in a reportable policy sale during any taxable year shall make a return for such taxable year (at such time and in such manner as the Secretary shall prescribe) setting forth—

''(A) the name, address, and TIN of such person,

''(B) the name, address, and TIN of each recipient of payment in the reportable policy sale,

''(C) the date of such sale,

''(D) the name of the issuer of the life insurance contract sold and the policy number of such contract, and

''(E) the amount of each payment.

''(2) STATEMENT TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under this subsection shall furnish to each person whose name is required to be set forth in such return a written statement showing—

''(A) the name, address, and phone number of the information contact of the person required to make such return, and

''(B) the information required to be shown on such return with respect to such person, except that in the case of an issuer of a life insurance contract, such statement is not required to include the information specified in paragraph (1)(E).

''(b) REQUIREMENT OF REPORTING OF SELLER'S BASIS IN LIFE INSURANCE CONTRACTS.—

''(1) IN GENERAL.—Upon receipt of the statement required under subsection (a)(2) or upon notice of a transfer of a life insurance contract to a foreign person, each issuer of a life insurance contract shall make a return (at such time and in such manner as the Secretary shall prescribe) setting forth—

''(A) the name, address, and TIN of the seller who transfers any interest in such contract in such sale,

''(B) the investment in the contract (as defined in section 72(e)(6)) with respect to such seller, and

''(C) the policy number of such contract.

''(2) STATEMENT TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under this subsection shall furnish to each person whose name is required to be set forth in such return a written statement showing—

''(A) the name, address, and phone number of the information contact of the person required to make such return, and

''(B) the information required to be shown on such return with respect to each seller whose name is required to be set forth in such return.

''(c) REQUIREMENT OF REPORTING WITH RESPECT TO REPORTABLE DEATH BENEFITS.—

''(1) IN GENERAL.—Every person who makes a payment of reportable death benefits during any taxable year shall make a return for such taxable year (at such time and in such manner as the Secretary shall prescribe) setting forth—

''(A) the name, address, and TIN of the person making such payment,

''(B) the name, address, and TIN of each recipient of such payment,

''(C) the date of each such payment,

''(D) the gross amount of each such payment, and

''(E) such person's estimate of the investment in the contract (as defined in section 72(e)(6)) with respect to the buyer.

''(2) STATEMENT TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under this subsection shall furnish to each person whose name is required to be set forth in such return a written statement showing—

''(A) the name, address, and phone number of the information contact of the person required to make such return, and

''(B) the information required to be shown on such return with respect to each recipient of payment whose name is required to be set forth in such return.

''(d) DEFINITIONS.—For purposes of this section:

''(1) PAYMENT.—The term 'payment' means, with respect to any reportable policy sale, the amount of cash and the fair market value of any consideration transferred in the sale.

''(2) REPORTABLE POLICY SALE.—The term 'reportable policy sale' has the meaning given such term in section 101(a)(3)(B).

''(3) ISSUER.—The term 'issuer' means any life insurance company that bears the risk with respect to a life insurance contract on the date any return or statement is required to be made under this section.

''(4) REPORTABLE DEATH BENEFITS.—The term 'reportable death benefits' means amounts paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale.''.

(b) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61, as amended by section 13306, is amended by inserting after the item relating to section 6050X the following new item:

''Sec. 6050Y. Returns relating to certain life insurance contract transactions.''.

(c) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 6724 is amended—

(A) by striking ''or'' at the end of clause (xxiv) of paragraph (1)(B), by striking ''and'' at the end of clause (xxv) of such paragraph and inserting ''or'', and by inserting after such clause (xxv) the following new clause:

''(xxvi) section 6050Y (relating to returns relating to certain life insurance contract transactions), and'', and

(B) by striking ''or'' at the end of subparagraph (HH) of paragraph (2), by striking the period at the end of subparagraph (II) of such paragraph and inserting '', or'', and by inserting after such subparagraph (II) the following new subparagraph:

''(JJ) subsection (a)(2), (b)(2), or (c)(2) of section 6050Y (relating to returns relating to certain life insurance contract transactions).''.

(2) Section 6047 is amended—

(A) by redesignating subsection (g) as subsection (h),

(B) by inserting after subsection (f) the following new subsection:

''(g) INFORMATION RELATING TO LIFE INSURANCE CONTRACT TRANSACTIONS.—This section shall not apply to any information which is required to be reported under section 6050Y.'', and

(C) by adding at the end of subsection (h), as so redesignated, the following new paragraph:

''(4) For provisions requiring reporting of information relating to certain life insurance contract transactions, see section 6050Y.''.

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

(1) reportable policy sales (as defined in section 6050Y(d)(2) of the Internal Revenue Code of 1986 (as added by subsection (a)) after December 31, 2017, and

(2) reportable death benefits (as defined in section 6050Y(d)(4) of such Code (as added by subsection (a)) paid after December 31, 2017.

SEC. 13521. CLARIFICATION OF TAX BASIS OF LIFE INSURANCE CONTRACTS.

(a) CLARIFICATION WITH RESPECT TO ADJUSTMENTS.—Paragraph (1) of section 1016(a) is amended by striking subparagraph (A) and all that follows and inserting the following:

''(A) for—

''(i) taxes or other carrying charges described in section 266; or

''(ii) expenditures described in section 173 (relating to circulation expenditures),

for which deductions have been taken by the taxpayer in determining taxable income for the taxable year or prior taxable years; or

''(B) for mortality, expense, or other reasonable charges incurred under an annuity or life insurance contract;''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to transactions entered into after August 25, 2009.

SEC. 13522. EXCEPTION TO TRANSFER FOR VALUABLE CONSIDERATION RULES.

(a) IN GENERAL.—Subsection (a) of section 101 is amended by inserting after paragraph (2) the following new paragraph:

''(3) EXCEPTION TO VALUABLE CONSIDERATION RULES FOR COMMERCIAL TRANSFERS.—

''(A) IN GENERAL.—The second sentence of paragraph (2) shall not apply in the case of a transfer of a life insurance contract, or any interest therein, which is a reportable policy sale.

''(B) REPORTABLE POLICY SALE.—For purposes of this paragraph, the term 'reportable policy sale' means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer's interest in such life insurance contract. For purposes of the preceding sentence, the term 'indirectly' applies to the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract.''.

(b) CONFORMING AMENDMENT.—Paragraph (1) of section 101(a) is amended by striking ''paragraph (2)'' and inserting ''paragraphs (2) and (3)''.

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

SEC. 13523. 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), determined by substituting '60-month period' for '24-month period' therein).''.

(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 subparagraph:

''(B) TREATMENT OF CERTAIN LOSSES.—

''(i) 3-YEAR LOSS PAYMENT PATTERN.—In the case of any line of business not described in subparagraph (A)(ii), losses paid after the 1st year following the accident year shall be treated as paid equally in the 2nd and 3rd year following the accident 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 24th year after the accident year, they shall be treated as paid in such 24th year.''.

(c) REPEAL OF HISTORICAL PAYMENT PATTERN ELECTION.—Section 846, as amended by this Act, 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.

Subpart C—Banks and Financial Instruments

SEC. 13531. LIMITATION ON DEDUCTION FOR FDIC PREMIUMS.

(a) IN GENERAL.—Section 162, as amended by sections 13307, is amended by redesignating subsection (r) as subsection (s) and by inserting after subsection (q) the following new subsection:

''(r) 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.—

''(i) IN GENERAL.—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).

''(ii) CONTROL OF NON-CORPORATE ENTITIES.—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 clause).''.

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

SEC. 13532. 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.

Subpart D—S Corporations

SEC. 13541. EXPANSION OF QUALIFYING BENEFICIARIES OF AN ELECTING SMALL BUSINESS TRUST.

(a) NO LOOK-THROUGH FOR ELIGIBILITY PURPOSES.—Section 1361(c)(2)(B)(v) is amended by adding at the end the following new sentence: ''This clause shall not apply for purposes of subsection (b)(1)(C).''.

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 2018.

SEC. 13542. CHARITABLE CONTRIBUTION DEDUCTION FOR ELECTING SMALL BUSINESS TRUSTS.

(a) IN GENERAL.—Section 641(c)(2) is amended by inserting after subparagraph (D) the following new subparagraph:

''(E)(i) Section 642(c) shall not apply.

''(ii) For purposes of section 170(b)(1)(G), adjusted gross income shall be computed in the same manner as in the case of an individual, except that the deductions for costs which are paid or incurred in connection with the administration of the trust and which would not have been incurred if the property were not held in such trust shall be treated as allowable in arriving at adjusted gross income.''.

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

SEC. 13543. 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.''.

PART VII—EMPLOYMENT

Subpart A—Compensation

SEC. 13601. 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.—Paragraph (4) of section 162(m) 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) MODIFICATION OF DEFINITION OF COVERED EMPLOYEES.—Paragraph (3) of section 162(m) 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 any individual described in subparagraph (A))'', 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.''.

(c) EXPANSION OF APPLICABLE EMPLOYER.—

(1) IN GENERAL.—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)).''.

(2) CONFORMING AMENDMENT.—Section 162(m)(3), as amended by subsection (b), is amended by adding at the end the following flush sentence:

''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.—Paragraph (4) of section 162(m), 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.—

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

(2) EXCEPTION FOR BINDING CONTRACTS.—The amendments made by this section shall not apply to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017, and which was not modified in any material respect on or after such date.

SEC. 13602. 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 the product of the rate of tax under section 11 and 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. For purposes of the preceding sentence, remuneration shall be treated as paid when there is no substantial risk of forfeiture (within the meaning of section 457(f)(3)(B)) of the rights to such remuneration.

''(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 which 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:

''(A) IN GENERAL.—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)) and shall include amounts required to be included in gross income under section 457(f).

''(B) EXCEPTION FOR REMUNERATION FOR MEDICAL SERVICES.—The term 'remuneration' shall not include the portion of any remuneration paid to a licensed medical professional (including a veterinarian) which is for the performance of medical or veterinary services by such professional.

''(4) REMUNERATION FROM RELATED ORGANIZATIONS.—

''(A) IN GENERAL.—Remuneration of a covered employee 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 which control the organization,

''(iii) is a supported organization (as defined in section 509(f)(3)) 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 which is a voluntary employees' beneficiary association described in section 501(c)(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 of 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.

''(C) EXCEPTION.—Such term does not include any payment—

''(i) described in section 280G(b)(6) (relating to exemption for payments under qualified plans),

''(ii) made under or to an annuity contract described in section 403(b) or a plan described in section 457(b),

''(iii) to a licensed medical professional (including a veterinarian) to the extent that such payment is for the performance of medical or veterinary services by such professional, or

''(iv) to an individual who is not a highly compensated employee as defined in section 414(q).

''(D) BASE AMOUNT.—Rules similar to the rules of 280G(b)(3) shall apply for purposes of determining the base amount.

''(E) 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 tax under this section, including regulations to prevent avoidance of such tax through the performance of services other than as an employee or by providing compensation through a pass-through or other entity to avoid such tax.''.

(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 tax-exempt organization executive compensation.''.

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

SEC. 13603. TREATMENT OF QUALIFIED EQUITY GRANTS.

(a) IN GENERAL.—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—

''(A) TIMING OF INCLUSION.—If qualified stock is transferred to a qualified employee who makes an election with respect to such stock under this subsection, subsection (a) shall be applied by including the amount determined under such subsection with respect to such stock in income of the employee in the taxable year determined under subparagraph (B) in lieu of the taxable year described in subsection (a).

''(B) TAXABLE YEAR DETERMINED.—The taxable year determined under this subparagraph is the taxable year of the employee which includes the earliest of—

''(i) the first date such qualified stock becomes transferable (including, solely for purposes of this clause, becoming 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 provides) 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 granted 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 are granted 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 made in a similar manner as 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 are 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 is a 1-percent owner (within the meaning of section 416(i)(1)(B)(ii)) at any time during the calendar year or who was such a 1 percent owner 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 is one of the 4 highest compensated officers of such corporation for the taxable year, or was one of the 4 highest compensated officers of such corporation for any of the 10 preceding taxable years, 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 date the rights of the employee in such stock are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, and shall be made in a manner similar to the manner in which an election is made under subsection (b).

''(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 date 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 subparagraph (B)(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 requires for purposes of administering this paragraph.

''(5) CONTROLLED GROUPS.—For purposes of this subsection, all persons treated as a single employer under section 414(b) shall be treated as 1 corporation.

''(6) NOTICE REQUIREMENT.—Any corporation which 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 be eligible to 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.''.

(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)(2)) 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 is amended—

(i) in subsection (b)(5), by striking ''and'' before ''the plan'' and by inserting '', and the rules of section 83(i) shall apply in determining which employees have a right to make an election under such section'' before the semicolon at the end, and

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

''(d) COORDINATION WITH QUALIFIED EQUITY GRANTS.—An option for which an election is made under section 83(i) with respect to the stock received in connection with its exercise shall not be considered as granted pursuant an employee stock purchase plan.''.

(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 with respect to such employee solely because of such 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 (14)(B), by striking the period at the end of paragraph (15) and inserting a comma, and by inserting after paragraph (15) the following new paragraphs:

''(16) the amount includible in gross income under subparagraph (A) of section 83(i)(1) with respect to an event described in subparagraph (B) of such section 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:

''(p) 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) issues 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.

SEC. 13604. INCREASE IN EXCISE TAX RATE FOR STOCK COMPENSATION OF INSIDERS IN EXPATRIATED CORPORATIONS.

(a) IN GENERAL.—Section 4985(a)(1) is amended by striking ''section 1(h)(1)(C)'' and inserting ''section 1(h)(1)(D)''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to corporations first becoming expatriated corporations (as defined in section 4985 of the Internal Revenue Code of 1986) after the date of enactment of this Act.

Subpart B—Retirement Plans

SEC. 13611. REPEAL OF SPECIAL RULE PERMITTING RECHARACTERIZATION OF ROTH CONVERSIONS.

(a) IN GENERAL.—Section 408A(d)(6)(B) is amended by adding at the end the following new clause:

''(iii) CONVERSIONS.—Subparagraph (A) shall not apply in the case of a qualified rollover contribution to which subsection (d)(3) applies (including by reason of subparagraph (C) thereof).''.

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

SEC. 13612. MODIFICATION OF RULES APPLICABLE TO LENGTH OF SERVICE AWARD PLANS.

(a) MAXIMUM DEFERRAL AMOUNT.—Clause (ii) of section 457(e)(11)(B) is amended by striking ''$3,000'' and inserting ''$6,000''.

(b) COST OF LIVING ADJUSTMENT.—Subparagraph (B) of section 457(e)(11) is amended by adding at the end the following:

''(iii) COST OF LIVING ADJUSTMENT.—In the case of taxable years beginning after December 31, 2017, the Secretary shall adjust the $6,000 amount under clause (ii) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2016, and any increase under this paragraph that is not a multiple of $500 shall be rounded to the next lowest multiple of $500.''.

(c) APPLICATION OF LIMITATION ON ACCRUALS.—Subparagraph (B) of section 457(e)(11), as amended by subsection (b), is amended by adding at the end the following:

''(iv) SPECIAL RULE FOR APPLICATION OF LIMITATION ON ACCRUALS FOR CERTAIN PLANS.—In the case of a plan described in subparagraph (A)(ii) which is a defined benefit plan (as defined in section 414(j)), the limitation under clause (ii) shall apply to the actuarial present value of the aggregate amount of length of service awards accruing with respect to any year of service. Such actuarial present value with respect to any year shall be calculated using reasonable actuarial assumptions and methods, assuming payment will be made under the most valuable form of payment under the plan with payment commencing at the later of the earliest age at which unreduced benefits are payable under the plan or the participant's age at the time of the calculation.''.

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

SEC. 13613. EXTENDED ROLLOVER PERIOD FOR PLAN LOAN OFFSET AMOUNTS.

(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 severance from employment of the participant.

''(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 AMENDMENTS.—Section 402(c)(3) is amended—

(1) by striking ''TRANSFER MUST BE MADE WITHIN 60 DAYS OF RECEIPT'' in the heading and inserting ''TIME LIMIT ON TRANSFERS'', and

(2) by striking ''subparagraph (B)'' in subparagraph (A) and inserting ''subparagraphs (B) and (C)''.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan loan offset amounts which are treated as distributed in taxable years beginning after December 31, 2017.

PART VIII—EXEMPT ORGANIZATIONS

SEC. 13701. 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. 4968. Excise tax based on investment income of private colleges and universities.

''SEC. 4968. 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(f)(2))—

''(A) which had at least 500 tuition-paying students during the preceding taxable year,

''(B) more than 50 percent of the tuition-paying students of which are located in the United States,

''(C) which is not described in the first sentence of section 511(a)(2)(B) (relating to State colleges and universities), and

''(D) 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 $500,000 per student of the institution.

''(2) STUDENTS.—For purposes of paragraph (1), the number of students of an institution (including for purposes of determining the number of students at a particular location) 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), assets and net investment income of any related organization with respect to an educational institution shall be treated as assets and net investment income, respectively, of the educational institution, except that—

''(A) no such amount shall be taken into account with respect to more than 1 educational institution, and

''(B) unless such organization is controlled by such institution or is described in section 509(a)(3) with respect to such institution for the taxable year, assets and net investment income which are not intended or available for the use or benefit of the educational institution shall not be taken into account.

''(2) RELATED ORGANIZATION.—For purposes of this subsection, the term 'related organization' means, with respect to an educational institution, any organization which—

''(A) controls, or is controlled by, such institution,

''(B) is controlled by 1 or more persons which also 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. 13702. UNRELATED BUSINESS TAXABLE INCOME SEPARATELY COMPUTED FOR EACH TRADE OR BUSINESS ACTIVITY.

(a) IN GENERAL.—Subsection (a) of section 512 is amended by adding at the end the following new paragraph:

''(6) SPECIAL RULE FOR ORGANIZATION WITH MORE THAN 1 UNRELATED TRADE OR BUSINESS.—In the case of any organization with more than 1 unrelated trade or business—

''(A) unrelated business taxable income, including for purposes of determining any net operating loss deduction, shall be computed separately with respect to each such trade or business and without regard to subsection (b)(12),

''(B) the unrelated business taxable income of such organization shall be the sum of the unrelated business taxable income so computed with respect to each such trade or business, less a specific deduction under subsection (b)(12), and

''(C) for purposes of subparagraph (B), unrelated business taxable income with respect to any such trade or business shall not be less than zero.''.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except to the extent provided in paragraph (2), the amendment made by this section shall apply to taxable years beginning after December 31, 2017.

(2) CARRYOVERS OF NET OPERATING LOSSES.—If any net operating loss arising in a taxable year beginning before January 1, 2018, is carried over to a taxable year beginning on or after such date—

(A) subparagraph (A) of section 512(a)(6) of the Internal Revenue Code of 1986, as added by this Act, shall not apply to such net operating loss, and

(B) the unrelated business taxable income of the organization, after the application of subparagraph (B) of such section, shall be reduced by the amount of such net operating loss.

SEC. 13703. UNRELATED BUSINESS TAXABLE INCOME INCREASED BY AMOUNT OF CERTAIN FRINGE BENEFIT EXPENSES FOR WHICH DEDUCTION IS DISALLOWED.

(a) IN GENERAL.—Section 512(a), as amended by this Act, is further amended by adding at the end the following new paragraph:

''(7) 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 shall 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. 13704. REPEAL OF DEDUCTION FOR AMOUNTS PAID IN EXCHANGE FOR COLLEGE ATHLETIC EVENT SEATING RIGHTS.

(a) IN GENERAL.—Section 170(l) is amended—

(1) by striking paragraph (1) and inserting the following:

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

(2) in paragraph (2)(B), by striking ''such amount would be allowable as a deduction under this section but for the fact that''.

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

SEC. 13705. REPEAL OF SUBSTANTIATION EXCEPTION IN CASE OF CONTRIBUTIONS REPORTED BY DONEE.

(a) IN GENERAL.—Section 170(f)(8) is amended by striking subparagraph (D) and by redesignating subparagraph (E) as subparagraph (D).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions made in taxable years beginning after December 31, 2016.

PART IX—OTHER PROVISIONS

Subpart A—Craft Beverage Modernization and Tax Reform

SEC. 13801. PRODUCTION PERIOD FOR BEER, WINE, AND DISTILLED SPIRITS.

(a) IN GENERAL.—Section 263A(f) is amended—

(1) by redesignating paragraph (4) as paragraph (5), and

(2) by inserting after paragraph (3) the following new paragraph:

''(4) EXEMPTION FOR AGING PROCESS OF BEER, WINE, AND DISTILLED SPIRITS.—

''(A) IN GENERAL.—For purposes of this subsection, the production period shall not include the aging period for—

''(i) beer (as defined in section 5052(a)),

''(ii) wine (as described in section 5041(a)), or

''(iii) distilled spirits (as defined in section 5002(a)(8)), except such spirits that are unfit for use for beverage purposes.

''(B) TERMINATION.—This paragraph shall not apply to interest costs paid or accrued after December 31, 2019.''.

(b) CONFORMING AMENDMENT.—Paragraph (5)(B)(ii) of section 263A(f), as redesignated by this section, is amended by inserting ''except as provided in paragraph (4),'' before ''ending on the date''.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to interest costs paid or accrued in calendar years beginning after December 31, 2017.

SEC. 13802. REDUCED RATE OF EXCISE TAX ON BEER.

(a) IN GENERAL.—Paragraph (1) of section 5051(a) is amended to read as follows:

''(1) IN GENERAL.—

''(A) IMPOSITION OF TAX.—A tax is hereby imposed on all beer brewed or produced, and removed for consumption or sale, within the United States, or imported into the United States. Except as provided in paragraph (2), the rate of such tax shall be the amount determined under this paragraph.

''(B) RATE.—Except as provided in subparagraph (C), the rate of tax shall be $18 for per barrel.

''(C) SPECIAL RULE.—In the case of beer removed after December 31, 2017, and before January 1, 2020, the rate of tax shall be—

''(i) $16 on the first 6,000,000 barrels of beer—

''(I) brewed by the brewer and removed during the calendar year for consumption or sale, or

''(II) imported by the importer into the United States during the calendar year, and

''(ii) $18 on any barrels of beer to which clause (i) does not apply.

''(D) BARREL.—For purposes of this section, a barrel shall contain not more than 31 gallons of beer, and any tax imposed under this section shall be applied at a like rate for any other quantity or for fractional parts of a barrel.''.

(b) REDUCED RATE FOR CERTAIN DOMESTIC PRODUCTION.—Subparagraph (A) of section 5051(a)(2) is amended—

(1) in the heading, by striking ''$7 A BARREL'', and

(2) by inserting ''($3.50 in the case of beer removed after December 31, 2017, and before January 1, 2020)'' after ''$7''.

(c) APPLICATION OF REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—Subsection (a) of section 5051 is amended—

(1) in subparagraph (C)(i)(II) of paragraph (1), as amended by subsection (a), by inserting ''but only if the importer is an electing importer under paragraph (4) and the barrels have been assigned to the importer pursuant to such paragraph'' after ''during the calendar year'', and

(2) by adding at the end the following new paragraph:

''(4) REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

''(A) IN GENERAL.—In the case of any barrels of beer which have been brewed or produced outside of the United States and imported into the United States, the rate of tax applicable under clause (i) of paragraph (1)(C) (referred to in this paragraph as the 'reduced tax rate') may be assigned by the brewer (provided that the brewer makes an election described in subparagraph (B)(ii)) to any electing importer of such barrels pursuant to the requirements established by the Secretary under subparagraph (B).

''(B) ASSIGNMENT.—The Secretary shall, through such rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the reduced tax rate provided under this paragraph, which shall include—

''(i) a limitation to ensure that the number of barrels of beer for which the reduced tax rate has been assigned by a brewer—

''(I) to any importer does not exceed the number of barrels of beer brewed or produced by such brewer during the calendar year which were imported into the United States by such importer, and

''(II) to all importers does not exceed the 6,000,000 barrels to which the reduced tax rate applies,

''(ii) procedures that allow the election of a brewer to assign and an importer to receive the reduced tax rate provided under this paragraph,

''(iii) requirements that the brewer provide any information as the Secretary determines necessary and appropriate for purposes of carrying out this paragraph, and

''(iv) procedures that allow for revocation of eligibility of the brewer and the importer for the reduced tax rate provided under this paragraph in the case of any erroneous or fraudulent information provided under clause (iii) which the Secretary deems to be material to qualifying for such reduced rate.

''(C) CONTROLLED GROUP.—For purposes of this section, any importer making an election described in subparagraph (B)(ii) shall be deemed to be a member of the controlled group of the brewer, as described under paragraph (5).''.

(d) CONTROLLED GROUP AND SINGLE TAXPAYER RULES.—Subsection (a) of section 5051, as amended by this section, is amended—

(1) in paragraph (2)—

(A) by striking subparagraph (B), and

(B) by redesignating subparagraph (C) as subparagraph (B), and

(2) by adding at the end the following new paragraph:

''(5) CONTROLLED GROUP AND SINGLE TAXPAYER RULES.—

''(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of a controlled group, the 6,000,000 barrel quantity specified in paragraph (1)(C)(i) and the 2,000,000 barrel quantity specified in paragraph (2)(A) shall be applied to the controlled group, and the 6,000,000 barrel quantity specified in paragraph (1)(C)(i) and the 60,000 barrel quantity specified in paragraph (2)(A) shall be apportioned among the brewers who are members of such group in such manner as the Secretary or their delegate shall by regulations prescribe. For purposes of the preceding sentence, the term 'controlled group' has the meaning assigned to it by subsection (a) of section 1563, except that for such purposes the phrase 'more than 50 percent' shall be substituted for the phrase 'at least 80 percent' in each place it appears in such subsection. Under regulations prescribed by the Secretary, principles similar to the principles of the preceding two sentences shall be applied to a group of brewers under common control where one or more of the brewers is not a corporation.

''(B) FOREIGN MANUFACTURERS AND IMPORTERS.—For purposes of paragraph (4), in the case of a controlled group, the 6,000,000 barrel quantity specified in paragraph (1)(C)(i) shall be applied to the controlled group and apportioned among the members of such group in such manner as the Secretary shall by regulations prescribe. For purposes of the preceding sentence, the term 'controlled group' has the meaning given such term under subparagraph (A). Under regulations prescribed by the Secretary, principles similar to the principles of the preceding two sentences shall be applied to a group of brewers under common control where one or more of the brewers is not a corporation.

''(C) SINGLE TAXPAYER.—Pursuant to rules issued by the Secretary, two or more entities (whether or not under common control) that produce beer marketed under a similar brand, license, franchise, or other arrangement shall be treated as a single taxpayer for purposes of the application of this subsection.''.

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

SEC. 13803. TRANSFER OF BEER BETWEEN BONDED FACILITIES.

(a) IN GENERAL.—Section 5414 is amended—

(1) by striking ''Beer may be removed'' and inserting ''(a) IN GENERAL—Beer may be removed'', and

(2) by adding at the end the following:

''(b) TRANSFER OF BEER BETWEEN BONDED FACILITIES.—

''(1) IN GENERAL.—Beer may be removed from one bonded brewery to another bonded brewery, without payment of tax, and may be mingled *with beer at the receiving brewery, subject to such conditions, including payment of the tax, and in such containers, as the Secretary by regulations shall prescribe, which shall include—*

''(A) any removal from one brewery to another brewery belonging to the same brewer,

''(B) any removal from a brewery owned by one corporation to a brewery owned by another corporation when—

''(i) one such corporation owns the controlling interest in the other such corporation, or

''(ii) the controlling interest in each such corporation is owned by the same person or persons, and

''(C) any removal from one brewery to another brewery when—

''(i) the proprietors of transferring and receiving premises are independent of each other and neither has a proprietary interest, directly or indirectly, in the business of the other, and

''(ii) the transferor has divested itself of all interest in the beer so transferred and the transferee has accepted responsibility for payment of the tax.

''(2) TRANSFER OF LIABILITY FOR TAX.—For purposes of paragraph (1)(C), such relief from liability shall be effective from the time of removal from the transferor's bonded premises, or from the time of divestment of interest, whichever is later.

''(3) TERMINATION.—This subsection shall not apply to any calendar quarter beginning after December 31, 2019.''.

(b) REMOVAL FROM BREWERY BY PIPELINE.—Section 5412 is amended by inserting ''pursuant to section 5414 or'' before ''by pipeline''.

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

SEC. 13804. REDUCED RATE OF EXCISE TAX ON CERTAIN WINE.

(a) IN GENERAL.—Section 5041(c) is amended by adding at the end the following new paragraph:

''(8) SPECIAL RULE FOR 2018 AND 2019.—

''(A) IN GENERAL.—In the case of wine removed after December 31, 2017, and before January 1, 2020, paragraphs (1) and (2) shall not apply and there shall be allowed as a credit against any tax imposed by this title (other than chapters 2, 21, and 22) an amount equal to the sum of—

''(i) $1 per wine gallon on the first 30,000 wine gallons of wine, plus

''(ii) 90 cents per wine gallon on the first 100,000 wine gallons of wine to which clause (i) does not apply, plus

''(iii) 53.5 cents per wine gallon on the first 620,000 wine gallons of wine to which clauses (i) and (ii) do not apply,

which are produced by the producer and removed during the calendar year for consumption or sale, or which are imported by the importer into the United States during the calendar year.

''(B) ADJUSTMENT OF CREDIT FOR HARD CIDER.—In the case of wine described in subsection (b)(6), subparagraph (A) of this paragraph shall be applied—

''(i) in clause (i) of such subparagraph, by substituting '6.2 cents' for '$1',

''(ii) in clause (ii) of such subparagraph, by substituting '5.6 cents' for '90 cents', and

''(iii) in clause (iii) of such subparagraph, by substituting '3.3 cents' for '53.5 cents'.'',

(b) CONTROLLED GROUP AND SINGLE TAXPAYER RULES.—Paragraph (4) of section 5041(c) is amended by striking ''section 5051(a)(2)(B)'' and inserting ''section 5051(a)(5)''.

(c) ALLOWANCE OF CREDIT FOR FOREIGN MANUFACTURERS AND IMPORTERS.—Subsection (c) of section 5041, as amended by subsection (a), is amended—

(1) in subparagraph (A) of paragraph (8), by inserting ''but only if the importer is an electing importer under paragraph (9) and the wine gallons of wine have been assigned to the importer pursuant to such paragraph'' after ''into the United States during the calendar year'', and

(2) by adding at the end the following new paragraph:

''(9) ALLOWANCE OF CREDIT FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

''(A) IN GENERAL.—In the case of any wine gallons of wine which have been produced outside of the United States and imported into the United States, the credit allowable under paragraph (8) (referred to in this paragraph as the 'tax credit') may be assigned by the person who produced such wine (referred to in this paragraph as the 'foreign producer'), provided that such person makes an election described in subparagraph (B)(ii), to any electing importer of such wine gallons pursuant to the requirements established by the Secretary under subparagraph (B).

''(B) ASSIGNMENT.—The Secretary shall, through such rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the tax credit provided under this paragraph, which shall include—

''(i) a limitation to ensure that the number of wine gallons of wine for which the tax credit has been assigned by a foreign producer—

''(I) to any importer does not exceed the number of wine gallons of wine produced by such foreign producer during the calendar year which were imported into the United States by such importer, and

''(II) to all importers does not exceed the 750,000 wine gallons of wine to which the tax credit applies,

''(ii) procedures that allow the election of a foreign producer to assign and an importer to receive the tax credit provided under this paragraph,

''(iii) requirements that the foreign producer provide any information as the Secretary determines necessary and appropriate for purposes of carrying out this paragraph, and

''(iv) procedures that allow for revocation of eligibility of the foreign producer and the importer for the tax credit provided under this paragraph in the case of any erroneous or fraudulent information provided under clause (iii) which the Secretary deems to be material to qualifying for such credit.

''(C) CONTROLLED GROUP.—For purposes of this section, any importer making an election described in subparagraph (B)(ii) shall be deemed to be a member of the controlled group of the foreign producer, as described under paragraph (4).''.

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

SEC. 13805. ADJUSTMENT OF ALCOHOL CONTENT LEVEL FOR APPLICATION OF EXCISE TAX RATES.

(a) IN GENERAL.—Paragraphs (1) and (2) of section 5041(b) are each amended by inserting ''(16 percent in the case of wine removed after December 31, 2017, and before January 1, 2020'' after ''14 percent''.

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

SEC. 13806. DEFINITION OF MEAD AND LOW ALCOHOL BY VOLUME WINE.

(a) IN GENERAL.—Section 5041 is amended—

(1) in subsection (a), by striking ''Still wines'' and inserting ''Subject to subsection (h), still wines'', and

(2) by adding at the end the following new subsection:

''(h) MEAD AND LOW ALCOHOL BY VOLUME WINE.—

''(1) IN GENERAL.—For purposes of subsections (a) and (b)(1), mead and low alcohol by volume wine shall be deemed to be still wines containing not more than 16 percent of alcohol by volume.

''(2) DEFINITIONS.—

''(A) MEAD.—For purposes of this section, the term 'mead' means a wine—

''(i) containing not more than 0.64 gram of carbon dioxide per hundred milliliters of wine, except that the Secretary shall by regulations prescribe such tolerances to this limitation as may be reasonably necessary in good commercial practice,

''(ii) which is derived solely from honey and water,

''(iii) which contains no fruit product or fruit flavoring, and

''(iv) which contains less than 8.5 percent alcohol by volume.

''(B) LOW ALCOHOL BY VOLUME WINE.—For purposes of this section, the term 'low alcohol by volume wine' means a wine—

''(i) containing not more than 0.64 gram of carbon dioxide per hundred milliliters of wine, except that the Secretary shall by regulations prescribe such tolerances to this limitation as may be reasonably necessary in good commercial practice,

''(ii) which is derived—

''(I) primarily from grapes, or

''(II) from grape juice concentrate and water,

''(iii) which contains no fruit product or fruit flavoring other than grape, and

''(iv) which contains less than 8.5 percent alcohol by volume.

''(3) TERMINATION.—This subsection shall not apply to wine removed after December 31, 2019.''.

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

SEC. 13807. REDUCED RATE OF EXCISE TAX ON CERTAIN DISTILLED SPIRITS.

(a) IN GENERAL.—Section 5001 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

''(c) REDUCED RATE FOR 2018 AND 2019.—

''(1) IN GENERAL.—In the case of a distilled spirits operation, the otherwise applicable tax rate under subsection (a)(1) shall be—

''(A) $2.70 per proof gallon on the first 100,000 proof gallons of distilled spirits, and

''(B) $13.34 per proof gallon on the first 22,130,000 of proof gallons of distilled spirits to which subparagraph (A) does not apply,

which have been distilled or processed by such operation and removed during the calendar year for consumption or sale, or which have been imported by the importer into the United States during the calendar year.

''(2) CONTROLLED GROUPS.—

''(A) IN GENERAL.—In the case of a controlled group, the proof gallon quantities specified under subparagraphs (A) and (B) of paragraph (1) shall be applied to such group and apportioned among the members of such group in such manner as the Secretary or their delegate shall by regulations prescribe.

''(B) DEFINITION.—For purposes of subparagraph (A), the term 'controlled group' shall have the meaning given such term by subsection (a) of section 1563, except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in such subsection.

''(C) RULES FOR NON-CORPORATIONS.—Under regulations prescribed by the Secretary, principles similar to the principles of subparagraphs (A) and (B) shall be applied to a group under common control where one or more of the persons is not a corporation.

''(D) SINGLE TAXPAYER.—Pursuant to rules issued by the Secretary, two or more entities (whether or not under common control) that produce distilled spirits marketed under a similar brand, license, franchise, or other arrangement shall be treated as a single taxpayer for purposes of the application of this subsection.

''(3) TERMINATION.—This subsection shall not apply to distilled spirits removed after December 31, 2019.''.

(b) CONFORMING AMENDMENT.—Section 7652(f)(2) is amended by striking ''section 5001(a)(1)'' and inserting ''subsection (a)(1) of section 5001, determined as if subsection (c)(1) of such section did not apply''.

(c) APPLICATION OF REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

Subsection (c) of section 5001, as added by subsection (a), is amended—

(1) in paragraph (1), by inserting ''but only if the importer is an electing importer under paragraph (3) and the proof gallons of distilled spirits have been assigned to the importer pursuant to such paragraph'' after ''into the United States during the calendar year'', and

(2) by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

''(3) REDUCED TAX RATE FOR FOREIGN MANUFACTURERS AND IMPORTERS.—

''(A) IN GENERAL.—In the case of any proof gallons of distilled spirits which have been produced outside of the United States and imported into the United States, the rate of tax applicable under paragraph (1) (referred to in this paragraph as the 'reduced tax rate') may be assigned by the distilled spirits operation (provided that such operation makes an election described in subparagraph (B)(ii)) to any electing importer of such proof gallons pursuant to the requirements established by the Secretary under subparagraph (B).

''(B) ASSIGNMENT.—The Secretary shall, through such rules, regulations, and procedures as are determined appropriate, establish procedures for assignment of the reduced tax rate provided under this paragraph, which shall include—

''(i) a limitation to ensure that the number of proof gallons of distilled spirits for which the reduced tax rate has been assigned by a distilled spirits operation—

''(I) to any importer does not exceed the number of proof gallons produced by such operation during the calendar year which were imported into the United States by such importer, and

''(II) to all importers does not exceed the 22,230,000 proof gallons of distilled spirits to which the reduced tax rate applies,

''(ii) procedures that allow the election of a distilled spirits operation to assign and an importer to receive the reduced tax rate provided under this paragraph,

''(iii) requirements that the distilled spirits operation provide any information as the Secretary determines necessary and appropriate for purposes of carrying out this paragraph, and

''(iv) procedures that allow for revocation of eligibility of the distilled spirits operation and the importer for the reduced tax rate provided under this paragraph in the case of any erroneous or fraudulent information provided under clause (iii) which the Secretary deems to be material to qualifying for such reduced rate.

''(C) CONTROLLED GROUP.—

''(i) IN GENERAL.—For purposes of this section, any importer making an election described in subparagraph (B)(ii) shall be deemed to be a member of the controlled group of the distilled spirits operation, as described under paragraph (2).

''(ii) APPORTIONMENT.—For purposes of this paragraph, in the case of a controlled group, rules similar to section 5051(a)(5)(B) shall apply.''.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distilled spirits removed after December 31, 2017.

SEC. 13808. BULK DISTILLED SPIRITS.

(a) IN GENERAL.—Section 5212 is amended by adding at the end the following sentence: ''In the case of distilled spirits transferred in bond after December 31, 2017, and before January 1, 2020, this section shall be applied without regard to whether distilled spirits are bulk distilled spirits.''.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply distilled spirits transferred in bond after December 31, 2017.

Subpart B—Miscellaneous Provisions

SEC. 13821. MODIFICATION OF TAX TREATMENT OF ALASKA NATIVE CORPORATIONS AND SETTLEMENT TRUSTS.

(a) EXCLUSION FOR ANCSA PAYMENTS ASSIGNED TO ALASKA NATIVE SETTLEMENT TRUSTS.—

(1) IN GENERAL.—Part III of subchapter B of chapter 1 is amended by inserting before section 140 the following new section:

''SEC. 139G. ASSIGNMENTS TO ALASKA NATIVE SETTLEMENT TRUSTS.

''(a) IN GENERAL.—In the case of a Native Corporation, gross income shall not include the value of any payments that would otherwise be made, or treated as being made, to such Native Corporation pursuant to, or as required by, any provision of the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), including any payment that would otherwise be made to a Village Corporation pursuant to section 7(j) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(j)), provided that any such payments—

''(1) are assigned in writing to a Settlement Trust, and

''(2) were not received by such Native Corporation prior to the assignment described in paragraph (1).

''(b) INCLUSION IN GROSS INCOME.—In the case of a Settlement Trust which has been assigned payments described in subsection (a), gross income shall include such payments when received by such Settlement Trust pursuant to the assignment and shall have the same character as if such payments were received by the Native Corporation.

''(c) AMOUNT AND SCOPE OF ASSIGNMENT.—The amount and scope of any assignment under subsection (a) shall be described with reasonable particularity and may either be in a percentage of one or more such payments or in a fixed dollar amount.

''(d) DURATION OF ASSIGNMENT; REVOCABILITY.—Any assignment under subsection (a) shall specify—

''(1) a duration either in perpetuity or for a period of time, and

''(2) whether such assignment is revocable.

''(e) PROHIBITION ON DEDUCTION.—Notwithstanding section 247, no deduction shall be allowed to a Native Corporation for purposes of any amounts described in subsection (a).

''(f) DEFINITIONS.—For purposes of this section, the terms 'Native Corporation' and 'Settlement Trust' have the same meaning given such terms under section 646(h).''.

(2) CONFORMING AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by inserting before the item relating to section 140 the following new item:

''Sec. 139G. Assignments to Alaska Native Settlement Trusts.''.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 2016.

(b) DEDUCTION OF CONTRIBUTIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.—

(1) IN GENERAL.—Part VIII of subchapter B of chapter 1 is amended by inserting before section 248 the following new section:

''SEC. 247. CONTRIBUTIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.

''(a) IN GENERAL.—In the case of a Native Corporation, there shall be allowed a deduction for any contributions made by such Native Corporation to a Settlement Trust (regardless of whether an election under section 646 is in effect for such Settlement Trust) for which the Native Corporation has made an annual election under subsection (e).

''(b) AMOUNT OF DEDUCTION.—The amount of the deduction under subsection (a) shall be equal to—

''(1) in the case of a cash contribution (regardless of the method of payment, including currency, coins, money order, or check), the amount of such contribution, or

''(2) in the case of a contribution not described in paragraph (1), the lesser of—

''(A) the Native Corporation's adjusted basis in the property contributed, or

''(B) the fair market value of the property contributed.

''(c) LIMITATION AND CARRYOVER.—

''(1) IN GENERAL.—Subject to paragraph (2), the deduction allowed under subsection (a) for any taxable year shall not exceed the taxable income (as determined without regard to such deduction) of the Native Corporation for the taxable year in which the contribution was made.

''(2) CARRYOVER.—If the aggregate amount of contributions described in subsection (a) for any taxable year exceeds the limitation under paragraph (1), such excess shall be treated as a contribution described in subsection (a) in each of the 15 succeeding years in order of time.

''(d) DEFINITIONS.—For purposes of this section, the terms 'Native Corporation' and 'Settlement Trust' have the same meaning given such terms under section 646(h).

''(e) MANNER OF MAKING ELECTION.—

''(1) IN GENERAL.—For each taxable year, a Native Corporation may elect to have this section apply for such taxable year on the income tax return or an amendment or supplement to the return of the Native Corporation, with such election to have effect solely for such taxable year.

''(2) REVOCATION.—Any election made by a Native Corporation pursuant to this subsection may be revoked pursuant to a timely filed amendment or supplement to the income tax return of such Native Corporation.

''(f) ADDITIONAL RULES.—

''(1) EARNINGS AND PROFITS.—Notwithstanding section 646(d)(2), in the case of a Native Corporation which claims a deduction under this section for any taxable year, the earnings and profits of such Native Corporation for such taxable year shall be reduced by the amount of such deduction.

''(2) GAIN OR LOSS.—No gain or loss shall be recognized by the Native Corporation with respect to a contribution of property for which a deduction is allowed under this section.

''(3) INCOME.—Subject to subsection (g), a Settlement Trust shall include in income the amount of any deduction allowed under this section in the taxable year in which the Settlement Trust actually receives such contribution.

''(4) PERIOD.—The holding period under section 1223 of the Settlement Trust shall include the period the property was held by the Native Corporation.

''(5) BASIS.—The basis that a Settlement Trust has for which a deduction is allowed under this section shall be equal to the lesser of—

''(A) the adjusted basis of the Native Corporation in such property immediately before such contribution, or

''(B) the fair market value of the property immediately before such contribution.

''(6) PROHIBITION.—No deduction shall be allowed under this section with respect to any contributions made to a Settlement Trust which are in violation of subsection (a)(2) or (c)(2) of section 39 of the Alaska Native Claims Settlement Act (43 U.S.C. 1629e).

''(g) ELECTION BY SETTLEMENT TRUST TO DEFER INCOME RECOGNITION.—

''(1) IN GENERAL.—In the case of a contribution which consists of property other than cash, a Settlement Trust may elect to defer recognition of any income related to such property until the sale or exchange of such property, in whole or in part, by the Settlement Trust.

''(2) TREATMENT.—In the case of property described in paragraph (1), any income or gain realized on the sale or exchange of such property shall be treated as—

''(A) for such amount of the income or gain as is equal to or less than the amount of income which would be included in income at the time of contribution under subsection (f)(3) but for the taxpayer's election under this subsection, ordinary income, and

''(B) for any amounts of the income or gain which are in excess of the amount of income which would be included in income at the time of contribution under subsection (f)(3) but for the taxpayer's election under this subsection,

having the same character as if this subsection did not apply.

''(3) ELECTION.—

''(A) IN GENERAL.—For each taxable year, a Settlement Trust may elect to apply this subsection for any property described in paragraph (1) which was contributed during such year. Any property to which the election applies shall be identified and described with reasonable particularity on the income tax return or an amendment or supplement to the return of the Settlement Trust, with such election to have effect solely for such taxable year.

''(B) REVOCATION.—Any election made by a Settlement Trust pursuant to this subsection may be revoked pursuant to a timely filed amendment or supplement to the income tax return of such Settlement Trust.

''(C) CERTAIN DISPOSITIONS.—

''(i) IN GENERAL.—In the case of any property for which an election is in effect under this subsection and which is disposed of within the first taxable year subsequent to the taxable year in which such property was contributed to the Settlement Trust—

''(I) this section shall be applied as if the election under this subsection had not been made,

''(II) any income or gain which would have been included in the year of contribution under subsection (f)(3) but for the taxpayer's election under this subsection shall be included in income for the taxable year of such contribution, and

''(III) the Settlement Trust shall pay any increase in tax resulting from such inclusion, including any applicable interest, and increased by 10 percent of the amount of such increase with interest.

''(ii) ASSESSMENT.—Notwithstanding section 6501(a), any amount described in subclause (III) of clause (i) may be assessed, or a proceeding in court with respect to such amount may be initiated without assessment, within 4 years after the date on which the return making the election under this subsection for such property was filed.''.

(2) CONFORMING AMENDMENT.—The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting before the item relating to section 248 the following new item:

''Sec. 247. Contributions to Alaska Native Settlement Trusts.''.

(3) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendments made by this subsection shall apply to taxable years for which the period of limitation on refund or credit under section 6511 of the Internal Revenue Code of 1986 has not expired.

(B) ONE-YEAR WAIVER OF STATUTE OF LIMITATIONS.—If the period of limitation on a credit or refund resulting from the amendments made by paragraph (1) expires before the end of the 1-year period beginning on the date of the enactment of this Act, refund or credit of such overpayment (to the extent attributable to such amendments) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 1-year period.

(c) INFORMATION REPORTING FOR DEDUCTIBLE CONTRIBUTIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.—

(1) IN GENERAL.—Section 6039H is amended—

*(A) in the heading, by striking ''***SPONSORING***'', and*

(B) by adding at the end the following new subsection:

''(e) DEDUCTIBLE CONTRIBUTIONS BY NATIVE CORPORATIONS TO ALASKA NATIVE SETTLEMENT TRUSTS.—

''(1) IN GENERAL.—Any Native Corporation (as defined in subsection (m) of section 3 of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m))) which has made a contribution to a Settlement Trust (as defined in subsection (t) of such section) to which an election under subsection (e) of section 247 applies shall provide such Settlement Trust with a statement regarding such election not later than January 31 of the calendar year subsequent to the calendar year in which the contribution was made.

''(2) CONTENT OF STATEMENT.—The statement described in paragraph (1) shall include—

''(A) the total amount of contributions to which the election under subsection (e) of section 247 applies,

''(B) for each contribution, whether such contribution was in cash,

''(C) for each contribution which consists of property other than cash, the date that such property was acquired by the Native Corporation and the adjusted basis and fair market value of such property on the date such property was contributed to the Settlement Trust,

''(D) the date on which each contribution was made to the Settlement Trust, and

''(E) such information as the Secretary determines to be necessary or appropriate for the identification of each contribution and the accurate inclusion of income relating to such contributions by the Settlement Trust.''.

(2) CONFORMING AMENDMENT.—The item relating to section 6039H in the table of sections for subpart A of part III of subchapter A of chapter 61 is amended to read as follows:

''Sec. 6039H. Information With Respect to Alaska Native Settlement Trusts and Native Corporations.''.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 2016.

SEC. 13822. AMOUNTS PAID FOR AIRCRAFT MANAGEMENT SERVICES.

(a) IN GENERAL.—Subsection (e) of section 4261 is amended by adding at the end the following new paragraph:

''(5) AMOUNTS PAID FOR AIRCRAFT MANAGEMENT SERVICES.—

''(A) IN GENERAL.—No tax shall be imposed by this section or section 4271 on any amounts paid by an aircraft owner for aircraft management services related to—

''(i) maintenance and support of the aircraft owner's aircraft, or

''(ii) flights on the aircraft owner's aircraft.

''(B) AIRCRAFT MANAGEMENT SERVICES.—For purposes of subparagraph (A), the term 'aircraft management services' includes—

''(i) assisting an aircraft owner with administrative and support services, such as scheduling, flight planning, and weather forecasting,

''(ii) obtaining insurance,

''(iii) maintenance, storage and fueling of aircraft,

''(iv) hiring, training, and provision of pilots and crew,

''(v) establishing and complying with safety standards, and

''(vi) such other services as are necessary to support flights operated by an aircraft owner.

''(C) LESSEE TREATED AS AIRCRAFT OWNER.—

''(i) IN GENERAL.—For purposes of this paragraph, the term 'aircraft owner' includes a person who leases the aircraft other than under a disqualified lease.

''(ii) DISQUALIFIED LEASE.—For purposes of clause (i), the term 'disqualified lease' means a lease from a person providing aircraft management services with respect to such aircraft (or a related person (within the meaning of section 465(b)(3)(C)) to the person providing such services), if such lease is for a term of 31 days or less.

''(D) PRO RATA ALLOCATION.—In the case of amounts paid to any person which (but for this subsection) are subject to the tax imposed by subsection (a), a portion of which consists of amounts described in subparagraph (A), this paragraph shall apply on a pro rata basis only to the portion which consists of amounts described in such subparagraph.''.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid after the date of the enactment of this Act.

SEC. 13823. OPPORTUNITY ZONES.

(a) IN GENERAL.—Chapter 1 is amended by adding at the end the following:

''Subchapter Z—Opportunity Zones

''Sec. 1400Z–1. Designation.

''Sec. 1400Z–2. Special rules for capital gains invested in opportunity zones.

''SEC. 1400Z–1. DESIGNATION.

''(a) QUALIFIED OPPORTUNITY ZONE DEFINED.—For the purposes of this subchapter, the term 'qualified opportunity zone' means a population census tract that is a low-income community that is designated as a qualified opportunity zone.

''(b) DESIGNATION.—

''(1) IN GENERAL.—For purposes of subsection (a), a population census tract that is a low-income community is designated as a qualified opportunity zone if—

''(A) not later than the end of the determination period, the chief executive officer of the State in which the tract is located—

''(i) nominates the tract for designation as a qualified opportunity zone, and

''(ii) notifies the Secretary in writing of such nomination, and

''(B) the Secretary certifies such nomination and designates such tract as a qualified opportunity zone before the end of the consideration period.

''(2) EXTENSION OF PERIODS.—A chief executive officer of a State may request that the Secretary extend either the determination or consideration period, or both (determined without regard to this subparagraph), for an additional 30 days.

''(c) OTHER DEFINITIONS.—For purposes of this subsection—

''(1) LOW-INCOME COMMUNITIES.—The term 'low-income community' has the same meaning as when used in section 45D(e).

''(2) DEFINITION OF PERIODS.—

''(A) CONSIDERATION PERIOD.—The term 'consideration period' means the 30-day period beginning on the date on which the Secretary receives notice under subsection (b)(1)(A)(ii), as extended under subsection (b)(2).

''(B) DETERMINATION PERIOD.—The term 'determination period' means the 90-day period beginning on the date of the enactment of the Tax Cuts and Jobs Act, as extended under subsection (b)(2).

''(3) STATE.—For purposes of this section, the term 'State' includes any possession of the United States.

''(d) NUMBER OF DESIGNATIONS.—

''(1) IN GENERAL.—Except as provided by paragraph (2), the number of population census tracts in a State that may be designated as qualified opportunity zones under this section may not exceed 25 percent of the number of low-income communities in the State.

''(2) EXCEPTION.—If the number of low-income communities in a State is less than 100, then a total of 25 of such tracts may be designated as qualified opportunity zones.

''(e) DESIGNATION OF TRACTS CONTIGUOUS WITH LOW-INCOME COMMUNITIES.—

''(1) IN GENERAL.—A population census tract that is not a low-income community may be designated as a qualified opportunity zone under this section if—

''(A) the tract is contiguous with the low-income community that is designated as a qualified opportunity zone, and

''(B) the median family income of the tract does not exceed 125 percent of the median family income of the low-income community with which the tract is contiguous.

''(2) LIMITATION.—Not more than 5 percent of the population census tracts designated in a State as a qualified opportunity zone may be designated under paragraph (1).

''(f) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—A designation as a qualified opportunity zone shall remain in effect for the period beginning on the date of the designation and ending at the close of the 10th calendar year beginning on or after such date of designation.

''SEC. 1400Z–2. SPECIAL RULES FOR CAPITAL GAINS INVESTED IN OPPORTUNITY ZONES.

''(a) IN GENERAL.—

''(1) TREATMENT OF GAINS.—In the case of gain from the sale to, or exchange with, an unrelated person of any property held by the taxpayer, at the election of the taxpayer—

''(A) gross income for the taxable year shall not include so much of such gain as does not exceed the aggregate amount invested by the taxpayer in a qualified opportunity fund during the 180-day period beginning on the date of such sale or exchange,

''(B) the amount of gain excluded by subparagraph (A) shall be included in gross income as provided by subsection (b), and

''(C) subsection (c) shall apply.

''(2) ELECTION.—No election may be made under paragraph (1)—

''(A) with respect to a sale or exchange if an election previously made with respect to such sale or exchange is in effect, or

''(B) with respect to any sale or exchange after December 31, 2026.

''(b) DEFERRAL OF GAIN INVESTED IN OPPORTUNITY ZONE PROPERTY.—

''(1) YEAR OF INCLUSION.—Gain to which subsection (a)(1)(B) applies shall be included in income in the taxable year which includes the earlier of—

''(A) the date on which such investment is sold or exchanged, or

''(B) December 31, 2026.

''(2) AMOUNT INCLUDIBLE.—

''(A) IN GENERAL.—The amount of gain included in gross income under subsection (a)(1)(A) shall be the excess of—

''(i) the lesser of the amount of gain excluded under paragraph (1) or the fair market value of the investment as determined as of the date described in paragraph (1), over

''(ii) the taxpayer's basis in the investment.

''(B) DETERMINATION OF BASIS.—

''(i) IN GENERAL.—Except as otherwise provided in this clause or subsection (c), the taxpayer's basis in the investment shall be zero.

''(ii) INCREASE FOR GAIN RECOGNIZED UNDER SUBSECTION (a)(1)(B).—The basis in the investment shall be increased by the amount of gain recognized by reason of subsection (a)(1)(B) with respect to such property.

''(iii) INVESTMENTS HELD FOR 5 YEARS.—In the case of any investment held for at least 5 years, the basis of such investment shall be increased by an amount equal to 10 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

''(iv) INVESTMENTS HELD FOR 7 YEARS.—In the case of any investment held by the taxpayer for at least 7 years, in addition to any adjustment made under clause (iii), the basis of such property shall be increased by an amount equal to 5 percent of the amount of gain deferred by reason of subsection (a)(1)(A).

''(c) SPECIAL RULE FOR INVESTMENTS HELD FOR AT LEAST 10 YEARS.—In the case of any investment held by the taxpayer for at least 10 years and with respect to which the taxpayer makes an election under this clause, the basis of such property shall be equal to the fair market value of such investment on the date that the investment is sold or exchanged.

''(d) QUALIFIED OPPORTUNITY FUND.—For purposes of this section—

''(1) IN GENERAL.—The term 'qualified opportunity fund' means any investment vehicle which is organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured—

''(A) on the last day of the first 6-month period of the taxable year of the fund, and

''(B) on the last day of the taxable year of the fund.

''(2) QUALIFIED OPPORTUNITY ZONE PROPERTY.—

''(A) IN GENERAL.—The term 'qualified opportunity zone property' means property which is—

''(i) qualified opportunity zone stock,

''(ii) qualified opportunity zone partnership interest, or

''(iii) qualified opportunity zone business property.

''(B) QUALIFIED OPPORTUNITY ZONE STOCK.—

''(i) IN GENERAL.—Except as provided in clause (ii), the term 'qualified opportunity zone stock' means any stock in a domestic corporation if—

''(I) such stock is acquired by the qualified opportunity fund after December 31, 2017, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

''(II) as of the time such stock was issued, such corporation was a qualified opportunity zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a qualified opportunity zone business), and

''(III) during substantially all of the qualified opportunity fund's holding period for such stock, such corporation qualified as a qualified opportunity zone business.

''(ii) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

''(C) QUALIFIED OPPORTUNITY ZONE PARTNERSHIP INTEREST.—The term 'qualified opportunity zone partnership interest' means any capital or profits interest in a domestic partnership if—

''(i) such interest is acquired by the qualified opportunity fund after December 31, 2017, from the partnership solely in exchange for cash,

''(ii) as of the time such interest was acquired, such partnership was a qualified opportunity zone business (or, in the case of a new partnership, such partnership was being organized for purposes of being a qualified opportunity zone business), and

''(iii) during substantially all of the qualified opportunity fund's holding period for such interest, such partnership qualified as a qualified opportunity zone business.

''(D) QUALIFIED OPPORTUNITY ZONE BUSINESS PROPERTY.—

''(i) IN GENERAL.—The term 'qualified opportunity zone business property' means tangible property used in a trade or business of the qualified opportunity fund if—

''(I) such property was acquired by the qualified opportunity fund by purchase (as defined in section 179(d)(2)) after December 31, 2017,

''(II) the original use of such property in the qualified opportunity zone commences with the qualified opportunity fund or the qualified opportunity fund substantially improves the property, and

''(III) during substantially all of the qualified opportunity fund's holding period for such property, substantially all of the use of such property was in a qualified opportunity zone.

''(ii) SUBSTANTIAL IMPROVEMENT.—For purposes of subparagraph (A)(ii), property shall be treated as substantially improved by the qualified opportunity fund only if, during any 30-month period beginning after the date of acquisition of such property, additions to basis with respect to such property in the hands of the qualified opportunity fund exceed an amount equal to the adjusted basis of such property at the beginning of such 30-month period in the hands of the qualified opportunity fund.

''(iii) RELATED PARTY.—For purposes of subparagraph (A)(i), the related person rule of section 179(d)(2) shall be applied pursuant to paragraph (8) of this subsection in lieu of the application of such rule in section 179(d)(2)(A).

''(3) QUALIFIED OPPORTUNITY ZONE BUSINESS.—

''(A) IN GENERAL.—The term 'qualified opportunity zone business' means a trade or business—

''(i) in which substantially all of the tangible property owned or leased by the taxpayer is qualified opportunity zone business property (determined by substituting 'qualified opportunity zone business' for 'qualified opportunity fund' each place it appears in paragraph (2)(D)),

''(ii) which satisfies the requirements of paragraphs (2), (4), and (8) of section 1397C(b), and

''(iii) which is not described in section 144(c)(6)(B).

''(B) SPECIAL RULE.—For purposes of subparagraph (A), tangible property that ceases to be a qualified opportunity zone business property shall continue to be treated as a qualified opportunity zone business property for the lesser of—

''(i) 5 years after the date on which such tangible property ceases to be so qualified, or

''(ii) the date on which such tangible property is no longer held by the qualified opportunity zone business.

''(e) APPLICABLE RULES.—

''(1) TREATMENT OF INVESTMENTS WITH MIXED FUNDS.—In the case of any investment in a qualified opportunity fund only a portion of which consists of investments of gain to which an election under subsection (a) is in effect—

''(A) such investment shall be treated as 2 separate investments, consisting of—

''(i) one investment that only includes amounts to which the election under subsection (a) applies, and

''(ii) a separate investment consisting of other amounts, and

''(B) subsections (a), (b), and (c) shall only apply to the investment described in subparagraph (A)(i).

''(2) RELATED PERSONS.—For purposes of this section, persons are related to each other if such persons are described in section 267(b) or 707(b)(1), determined by substituting '20 percent' for '50 percent' each place it occurs in such sections.

''(3) DECEDENTS.—In the case of a decedent, amounts recognized under this section shall, if not properly includible in the gross income of the decedent, be includible in gross income as provided by section 691.

''(4) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

''(A) rules for the certification of qualified opportunity funds for the purposes of this section,

''(B) rules to ensure a qualified opportunity fund has a reasonable period of time to reinvest the return of capital from investments in qualified opportunity zone stock and qualified opportunity zone partnership interests, and to reinvest proceeds received from the sale or disposition of qualified opportunity zone property, and

''(C) rules to prevent abuse.

''(f) FAILURE OF QUALIFIED OPPORTUNITY FUND TO MAINTAIN INVESTMENT STANDARD.—

''(1) IN GENERAL.—If a qualified opportunity fund fails to meet the 90-percent requirement of subsection (c)(1), the qualified opportunity fund shall pay a penalty for each month it fails to meet the requirement in an amount equal to the product of—

''(A) the excess of—

''(i) the amount equal to 90 percent of its aggregate assets, over

''(ii) the aggregate amount of qualified opportunity zone property held by the fund, multiplied by

''(B) the underpayment rate established under section 6621(a)(2) for such month.

''(2) SPECIAL RULE FOR PARTNERSHIPS.—In the case that the qualified opportunity fund is a partnership, the penalty imposed by paragraph (1) shall be taken into account proportionately as part of the distributive share of each partner of the partnership.

''(3) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with respect to any failure if it is shown that such failure is due to reasonable cause.''.

(b) BASIS ADJUSTMENTS.—Section 1016(a) is amended by striking ''and'' at the end of paragraph (36), by striking the period at the end of

paragraph (37) and inserting '', and'', and by inserting after paragraph (37) the following:

''(38) to the extent provided in subsections (b)(2) and (c) of section 1400Z–2.''.

(c) CLERICAL AMENDMENT.—The table of subchapters for chapter 1 is amended by adding at the end the following new item:

''SUBCHAPTER Z. OPPORTUNITY ZONES''.

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

Subtitle D—International Tax Provisions

PART I—OUTBOUND TRANSACTIONS

Subpart A—Establishment of Participation Exemption System for Taxation of Foreign Income

SEC. 14101. 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—

''(1) IN GENERAL.—The term 'specified 10-percent owned foreign corporation' means any foreign corporation with respect to which any domestic corporation is a United States shareholder with respect to such corporation.

''(2) EXCLUSION OF PASSIVE FOREIGN INVESTMENT COMPANIES.—Such term shall not include any corporation which is a passive foreign investment company (as defined in section 1297) with respect to the shareholder and which 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 from a specified 10-percent owned foreign corporation is an amount which bears the same ratio to such dividend as—

''(A) the undistributed foreign earnings of the specified 10-percent owned foreign corporation, bears to

''(B) the total undistributed earnings of such foreign corporation.

''(2) UNDISTRIBUTED EARNINGS.—The term '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)—

''(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) UNDISTRIBUTED FOREIGN EARNINGS.—The term 'undistributed foreign earnings' means the portion of the 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)).

''(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) SPECIAL RULES FOR HYBRID DIVIDENDS.—

''(1) IN GENERAL.—Subsection (a) shall not apply to any dividend received by a United States shareholder from a controlled foreign corporation if the dividend is a hybrid dividend.

''(2) HYBRID DIVIDENDS OF TIERED CORPORATIONS.—If a controlled foreign corporation with respect to which a domestic corporation is a United States shareholder receives a hybrid dividend from any other controlled foreign corporation with respect to which such domestic corporation is also a United States shareholder, then, notwithstanding any other provision of this title—

''(A) the hybrid dividend shall be treated for purposes of section 951(a)(1)(A) as subpart F income of the receiving controlled foreign corporation for the taxable year of the controlled foreign corporation in which the dividend was received, and

''(B) the United States shareholder shall include in gross income an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the subpart F income described in subparagraph (A).

''(3) DENIAL OF FOREIGN TAX CREDIT, ETC.—The rules of subsection (d) shall apply to any hybrid dividend received by, or any amount included under paragraph (2) in the gross income of, a United States shareholder.

''(4) HYBRID DIVIDEND.—The term 'hybrid dividend' means an amount received from a controlled foreign corporation—

''(A) for which a deduction would be allowed under subsection (a) but for this subsection, and

''(B) for which the controlled foreign corporation received a deduction (or other tax benefit) with respect to any income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States.

''(f) SPECIAL RULE FOR PURGING DISTRIBUTIONS OF PASSIVE FOREIGN INVESTMENT COMPANIES.—Any amount which is treated as a dividend under section 1291(d)(2)(B) shall not be treated as a dividend for purposes of this section.

''(g) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including regulations for the treatment of United States shareholders owning stock of a specified 10 percent owned foreign corporation through a partnership.''.

(b) APPLICATION OF HOLDING PERIOD REQUIREMENT.—Subsection (c) of section 246 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) 1-YEAR HOLDING PERIOD REQUIREMENT.—For purposes of section 245A—

''(i) paragraph (1)(A) shall be applied—

''(I) by substituting '365 days' for '45 days' each place it appears, and

''(II) by substituting '731-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 at all times during such period, and

''(ii) the taxpayer is a United States shareholder with respect to such specified 10-percent owned foreign corporation at all times during such period.''.

(c) APPLICATION OF RULES GENERALLY APPLICABLE TO DEDUCTIONS FOR DIVIDENDS RECEIVED.—

(1) TREATMENT OF DIVIDENDS FROM CERTAIN CORPORATIONS.—Paragraph (1) of section 246(a) is amended by striking ''and 245'' and inserting ''245, and 245A''.

(2) COORDINATION WITH SECTION 1059.—Subparagraph (B) of section 1059(b)(2) is amended by striking ''or 245'' and inserting ''245, or 245A''.

(d) COORDINATION WITH FOREIGN TAX CREDIT LIMITATION.—Subsection (b) of section 904 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 domestic corporation which is 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 amounts includible under section 951(a)(1) or 951A(a)) 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 amounts includible under section 951(a)(1) or 951A(a).

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) Subsection (b) of section 951 is amended by striking ''subpart'' and inserting ''title''.

(2) Subsection (a) of section 957 is amended by striking ''subpart'' in the matter preceding paragraph (1) and inserting ''title''.

(3) The table of sections for part VIII of subchapter B of chapter 1 is amended by inserting after the item relating to section 245 the following new item:

''Sec. 245A. Deduction for foreign source-portion of dividends received by domestic corporations from certain 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. 14102. SPECIAL RULES RELATING TO SALES OR TRANSFERS INVOLVING SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS.

(a) SALES BY UNITED STATES PERSONS OF STOCK.—

(1) IN GENERAL.—Section 1248 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

''(j) COORDINATION WITH DIVIDENDS RECEIVED DEDUCTION.—In the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for 1 year or more, any amount received by the domestic corporation which is treated as a dividend by reason of this section shall be treated as a dividend for purposes of applying section 245A.''.

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to sales or exchanges after December 31, 2017.

(b) 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.

(c) SALE BY A CFC OF A LOWER TIER CFC.—

(1) IN GENERAL.—Section 964(e) is amended by adding at the end the following new paragraph:

''(4) COORDINATION WITH DIVIDENDS RECEIVED DEDUCTION.—

''(A) IN GENERAL.—If, for any taxable year of a controlled foreign corporation beginning after December 31, 2017, any amount is treated as a dividend under paragraph (1) by reason of a sale or exchange by the controlled foreign corporation of stock in another foreign corporation held for 1 year or more, then, notwithstanding any other provision of this title—

''(i) the foreign-source portion of such dividend shall be treated for purposes of section 951(a)(1)(A) as subpart F income of the selling controlled foreign corporation for such taxable year,

''(ii) a United States shareholder with respect to the selling controlled foreign corporation shall include in gross income for the taxable year of the shareholder with or within which such taxable year of the controlled foreign corporation ends an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the amount treated as subpart F income under clause (i), and

''(iii) the deduction under section 245A(a) shall be allowable to the United States shareholder with respect to the subpart F income included in gross income under clause (ii) in the same manner as if such subpart F income were a dividend received by the shareholder from the selling controlled foreign corporation.

''(B) APPLICATION OF BASIS OR SIMILAR ADJUSTMENT.—For purposes of this title, in the case of a sale or exchange by a controlled foreign corporation of stock in another foreign corporation in a taxable year of the selling controlled foreign corporation beginning after December 31, 2017, rules similar to the rules of section 961(d) shall apply.

''(C) FOREIGN-SOURCE PORTION.—For purposes of this paragraph, the foreign-source portion of any amount treated as a dividend under paragraph (1) shall be determined in the same manner as under section 245A(c).''.

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to sales or exchanges after December 31, 2017.

(d) 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), as in effect before the date of the enactment of the Tax Cuts and Jobs Act) 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.—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 (b)(2)(B)).

''(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 shall 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) 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.''.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to transfers after December 31, 2017.

(4) TRANSITION RULE.—The amount of gain taken into account under section 91(c) of the Internal Revenue Code of 1986, as added by this subsection, shall be reduced by the amount of gain which would be recognized under section 367(a)(3)(C) (determined without regard to the amendments made by subsection (e)) with respect to losses incurred before January 1, 2018.

(e) REPEAL OF ACTIVE TRADE OR BUSINESS EXCEPTION UNDER SECTION 367.—

(1) IN GENERAL.—Section 367(a) is amended by striking paragraph (3) and redesignating paragraphs (4), (5), and (6) as paragraphs (3), (4), and (5), respectively.

(2) CONFORMING AMENDMENTS.—Section 367(a)(4), as redesignated by paragraph (1), is amended—

(A) by striking ''Paragraphs (2) and (3)'' and inserting ''Paragraph (2)'', and

(B) by striking ''PARAGRAPHS (2) AND (3)'' in the heading and inserting ''PARAGRAPH (2)''.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to transfers after December 31, 2017.

SEC. 14103. 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 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.—

''(i) IN GENERAL.—The term 'aggregate foreign E&P deficit' means, with respect to any United States shareholder, the lesser of—

''(I) 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, or

''(II) the amount determined under paragraph (2)(B).

''(ii) ALLOCATION OF DEFICIT.—If the amount described in clause (i)(II) is less than the amount described in clause (i)(I), then the shareholder shall designate, in such form and manner as the Secretary determines—

''(I) the amount of the specified E&P deficit which is to be taken into account for each E&P deficit corporation with respect to the taxpayer, and

''(II) in the case of an E&P deficit corporation which has a qualified deficit (as defined in section 952), the portion (if any) of the deficit taken into account under subclause (I) which is attributable to a qualified deficit, including the qualified activities to which such portion is attributable.

''(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, as of November 2, 2017—

''(i) such specified foreign corporation has a deficit in post-1986 earnings and profits,

''(ii) such corporation was a specified foreign corporation, and

''(iii) 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) TREATMENT OF EARNINGS AND PROFITS IN FUTURE YEARS.—

''(A) REDUCED EARNINGS AND PROFITS TREATED AS PREVIOUSLY TAXED INCOME WHEN DISTRIBUTED.—For purposes of applying section 959 in any taxable year beginning with the taxable year described in subsection (a), with respect to any United States shareholder of a deferred foreign income corporation, an amount equal to such shareholder's reduction under paragraph (1) which is allocated to such deferred foreign income corporation under this subsection shall be treated as an amount which was included in the gross income of such United States shareholder under section 951(a).

''(B) E&P DEFICITS.—For purposes of this title, with respect to any taxable year beginning with the taxable year described in subsection (a), a United States shareholder's pro rata share of the earnings and profits of any E&P deficit foreign corporation under this subsection shall be increased by the amount of the specified E&P deficit of such corporation taken into account by such shareholder under paragraph (1), and, for purposes of section 952, such increase shall be attributable to the same activity to which the deficit so taken into account was attributable.

''(5) 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) without regard to clause (i)(II) thereof), 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 8 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 15.5 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) 8 AND 15.5 PERCENT RATE EQUIVALENT PERCENTAGES.—For purposes of this subsection—

''(A) 8 PERCENT RATE EQUIVALENT PERCENTAGE.—The term '8 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 8 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) 15.5 PERCENT RATE EQUIVALENT PERCENTAGE.—The term '15.5 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 '15.5 percent rate of tax' for '8 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, the greater 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 the close of the last taxable year of such specified foreign corporation which begins before January 1, 2018, or

''(ii) one half of the sum of—

''(I) 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, plus

''(II) 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 subclause (I).

''(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) Personal property which is of a type that is actively traded and 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.—Cash positions of a specified foreign corporation described in clause (ii), (iii)(I), or (iii)(IV) of subparagraph (B) shall not be taken into account by a United States shareholder under subparagraph (A) to the extent that such United States shareholder demonstrates to the satisfaction of the Secretary that such amount is so taken into account by such United States shareholder with respect to another specified foreign corporation.

''(E) CASH POSITIONS OF CERTAIN NON-CORPORATE ENTITIES TAKEN INTO ACCOUNT.—An entity (other than a 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.

''(F) ANTI-ABUSE.—If the Secretary determines that a 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)) 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) in the case of a controlled foreign corporation, 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, and by only taking into account periods when the foreign corporation was a specified foreign corporation) 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, and

''(B) without diminution by reason of dividends distributed during the taxable year described in subsection (a) other than dividends distributed to another specified foreign corporation.

''(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.

''(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) EXCLUSION OF PASSIVE FOREIGN INVESTMENT COMPANIES.—Such term shall not include any corporation which is a passive foreign investment company (as defined in section 1297) with respect to the shareholder and which is not a controlled foreign corporation.

''(f) DETERMINATIONS OF PRO RATA SHARE.—

''(1) IN GENERAL.—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).

''(2) SPECIAL RULES.—The portion which is included in the income of a United States shareholder under section 951(a)(1) by reason of subsection (a) which is equal to the deduction allowed under subsection (c) by reason of such inclusion—

''(A) shall be treated as income exempt from tax for purposes of sections 705(a)(1)(B) and 1367(a)(1)(A), and

''(B) shall not be treated as income exempt from tax for purposes of determining whether an adjustment shall be made to an accumulated adjustment account under section 1368(e)(1)(A).

''(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) 0.771 multiplied by 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) 0.557 multiplied by 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.

''(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 installments of the following amounts:

''(A) 8 percent of the net tax liability in the case of each of the first 5 of such installments,

''(B) 15 percent of the net tax liability in the case of the 6th such installment,

''(C) 20 percent of the net tax liability in the case of the 7th such installment, and

''(D) 25 percent of the net tax liability in the case of the 8th such installment.

''(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 shall 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 or deduction 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 of tax 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) of subparagraph (A) 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.—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 shall provide.

''(j) REPORTING BY S CORPORATION.—Each S corporation which is a United States shareholder of a specified foreign 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) EXTENSION OF LIMITATION ON ASSESSMENT.—Notwithstanding section 6501, the limitation on the time period for the assessment of the net tax liability under this section (as defined in subsection (h)(6)) shall not expire before the date that is 6 years after the return for the taxable year described in such subsection was filed.

''(l) RECAPTURE FOR EXPATRIATED ENTITIES.—

''(1) IN GENERAL.—If a deduction is allowed under subsection (c) to a United States shareholder and such shareholder first becomes an expatriated entity at any time during the 10-year period beginning on the date of the enactment of the Tax Cuts and Jobs Act (with respect to a surrogate foreign corporation which first becomes a surrogate foreign corporation during such period), then—

''(A) the tax imposed by this chapter shall be increased for the first taxable year in which such taxpayer becomes an expatriated entity by an amount equal to 35 percent of the amount of the deduction allowed under subsection (c), and

''(B) no credits shall be allowed against the increase in tax under subparagraph (A).

''(2) EXPATRIATED ENTITY.—For purposes of this subsection, the term 'expatriated entity' has the same meaning given such term under section 7874(a)(2), except that such term shall not include an entity if the surrogate foreign corporation with respect to the entity is treated as a domestic corporation under section 7874(b).

''(3) SURROGATE FOREIGN CORPORATION.—For purposes of this subsection, the term 'surrogate foreign corporation' has the meaning given such term in section 7874(a)(2)(B).

''(m) SPECIAL RULES FOR UNITED STATES SHAREHOLDERS WHICH ARE REAL ESTATE INVESTMENT TRUSTS.—

''(1) IN GENERAL.—If a real estate investment trust is a United States shareholder in 1 or more deferred foreign income corporations—

''(A) any amount required to be taken into account under section 951(a)(1) by reason of this section shall not be taken into account as gross income of the real estate investment trust for purposes of applying paragraphs (2) and (3) of section 856(c) to any taxable year for which such amount is taken into account under section 951(a)(1), and

''(B) if the real estate investment trust elects the application of this subparagraph, notwithstanding subsection (a), any amount required to be taken into account under section 951(a)(1) by reason of this section shall, in lieu of the taxable year in which it would otherwise be included in gross income (for purposes of the computation of real estate investment trust taxable income under section 857(b)), be included in gross income as follows:

''(i) 8 percent of such amount in the case of each of the taxable years in the 5-taxable year period beginning with the taxable year in which such amount would otherwise be included.

''(ii) 15 percent of such amount in the case of the 1st taxable year following such period.

''(iii) 20 percent of such amount in the case of the 2nd taxable year following such period.

''(iv) 25 percent of such amount in the case of the 3rd taxable year following such period.

''(2) RULES FOR TRUSTS ELECTING DEFERRED INCLUSION.—

''(A) ELECTION.—Any election under paragraph (1)(B) shall be made not later than the due date for the first taxable year in the 5-taxable year period described in clause (i) of paragraph (1)(B) and shall be made in such manner as the Secretary shall provide.

''(B) SPECIAL RULES.—If an election under paragraph (1)(B) is in effect with respect to any real estate investment trust, the following rules shall apply:

''(i) APPLICATION OF PARTICIPATION EXEMPTION.—For purposes of subsection (c)(1)—

''(I) the aggregate amount to which subparagraph (A) or (B) of subsection (c)(1) applies shall be determined without regard to the election,

''(II) each such aggregate amount shall be allocated to each taxable year described in paragraph (1)(B) in the same proportion as the amount included in the gross income of such United States shareholder under section 951(a)(1) by reason of this section is allocated to each such taxable year.

''(III) NO INSTALLMENT PAYMENTS.—The real estate investment trust may not make an election under subsection (g) for any taxable year described in paragraph (1)(B).

''(ii) ACCELERATION OF INCLUSION.—If there is a liquidation or sale of substantially all the assets of the real estate investment trust (including in a title 11 or similar case), a cessation of business by such trust, or any similar circumstance, then any amount not yet included in gross income under paragraph (1)(B) shall be included in gross income as of the day before the date of the event and the unpaid portion of any tax liability with respect to such inclusion 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).

''(n) ELECTION NOT TO APPLY NET OPERATING LOSS DEDUCTION.—

''(1) IN GENERAL.—If a United States shareholder of a deferred foreign income corporation elects the application of this subsection for the taxable year described in subsection (a), then the amount described in paragraph (2) shall not be taken into account—

''(A) in determining the amount of the net operating loss deduction under section 172 of such shareholder for such taxable year, or

''(B) in determining the amount of taxable income for such taxable year which may be reduced by net operating loss carryovers or carrybacks to such taxable year under section 172.

''(2) AMOUNT DESCRIBED.—The amount described in this paragraph is the sum of—

''(A) the amount required to be taken into account under section 951(a)(1) by reason of this section (determined after the application of subsection (c)), plus

''(B) in the case of a domestic corporation which chooses to have the benefits of subpart A of part III of subchapter N for the taxable year, the taxes deemed to be paid by such corporation under subsections (a) and (b) of section 960 for such taxable year with respect to the amount described in subparagraph (A) which are treated as a dividends under section 78.

''(3) ELECTION.—Any election under this subsection shall be made not later than the due date (including extensions) for filing the return of tax for the taxable year and shall be made in such manner as the Secretary shall prescribe.

''(o) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including—

''(1) regulations or other guidance to provide appropriate basis adjustments, and

''(2) regulations or other guidance to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise.''.

(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.''.

Subpart B—Rules Related to Passive and Mobile Income

CHAPTER 1—TAXATION OF FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME

SEC. 14201. CURRENT YEAR INCLUSION OF GLOBAL INTANGIBLE LOW-TAXED INCOME BY UNITED STATES SHAREHOLDERS.

(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. GLOBAL INTANGIBLE LOW-TAXED INCOME 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 such shareholder's global intangible low-taxed income for such taxable year.

''(b) GLOBAL INTANGIBLE LOW-TAXED INCOME.—For purposes of this section—

''(1) IN GENERAL.—The term 'global intangible low-taxed income' 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) such shareholder's net deemed tangible income return for such taxable year.

''(2) NET DEEMED TANGIBLE INCOME RETURN.—The term 'net deemed tangible income return' means, with respect to any United States shareholder for any taxable year, the excess of—

''(A) 10 percent 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

''(B) 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 to the extent the interest income attributable to such expense is not taken into account in determining such shareholder's net CFC tested income.

''(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 described in section 952(b),

''(II) any gross income taken into account in determining the subpart F income of such corporation,

''(III) any gross income excluded from the foreign base company income (as defined in section 954) and the insurance income (as defined in section 953) of such corporation by reason of section 954(b)(4),

''(IV) any dividend received from a related person (as defined in section 954(d)(3)), and

''(V) any foreign oil and gas extraction income (as defined in section 907(c)(1)) 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 to which such deductions would be allocable if there were such gross income).

''(B) TESTED LOSS.—

''(i) IN GENERAL.—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).

''(ii) COORDINATION WITH SUBPART F TO DENY DOUBLE BENEFIT OF LOSSES.—Section 952(c)(1)(A) shall be applied by increasing the earnings and profits of the controlled foreign corporation by the tested loss of such corporation.

''(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, the average of such corporation's aggregate adjusted bases as of the close of each quarter of 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 167.

''(2) SPECIFIED TANGIBLE PROPERTY.—

''(A) IN GENERAL.—The term 'specified tangible property' means, except as provided in subparagraph (B), any tangible property used in the production of tested income.

''(B) DUAL USE PROPERTY.—In the case of property used both in the production of tested income and income which is not tested income, such property shall be treated as specified tangible property in the same proportion that the gross income described in subsection (c)(1)(A) produced with respect to such property bears to the total gross income produced with respect to such property.

''(3) DETERMINATION OF ADJUSTED BASIS.—For purposes of this subsection, notwithstanding any provision of this title (or any other provision of law) which is enacted after the date of the enactment of this section, the adjusted basis in any property shall be determined—

''(A) by using the alternative depreciation system under section 168(g), and

''(B) by allocating the depreciation deduction with respect to such property ratably to each day during the period in the taxable year to which such depreciation relates.

''(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 167, and

''(C) is used in the production of tested income (determined with respect to such controlled foreign corporation's distributive share of income 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 with respect to such property.

''(4) 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) DETERMINATION OF PRO RATA SHARE, ETC.—For purposes of this section—

''(1) IN GENERAL.—The pro rata shares referred to in subsections (b), (c)(1)(A), and (c)(1)(B), respectively, shall be determined under the rules of section 951(a)(2) in the same manner as such section applies to subpart F income and shall be taken into account in the taxable year of the United States shareholder in which or with which the taxable year of the controlled foreign corporation ends.

''(2) TREATMENT AS UNITED STATES SHAREHOLDER.—A person shall be treated as a United States shareholder of a controlled foreign corporation for any taxable year of such person only if such person owns (within the meaning of section 958(a)) stock in such foreign corporation on the last day in the taxable year of such foreign corporation on which such foreign corporation is a controlled foreign corporation.

''(3) TREATMENT AS CONTROLLED FOREIGN CORPORATION.—A foreign corporation shall be treated as a controlled foreign corporation for any taxable year if such foreign corporation is a controlled foreign corporation at any time during such taxable year.

''(f) TREATMENT AS SUBPART F INCOME FOR CERTAIN PURPOSES.—

''(1) IN GENERAL.—

''(A) APPLICATION.—Except as provided in subparagraph (B), any global intangible low-taxed income 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).

''(B) EXCEPTION.—The Secretary shall provide rules for the application of subparagraph (A) to other provisions of this title in any case in which the determination of subpart F income is required to be made at the level of the controlled foreign corporation.

''(2) ALLOCATION OF GLOBAL INTANGIBLE LOW-TAXED INCOME 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 global intangible low-taxed income included in gross income of a United States shareholder under subsection (a), the portion of such global intangible low-taxed income which is treated as being with respect to such controlled foreign corporation is—

''(A) in the case of a controlled foreign corporation with no tested income, zero, and

''(B) in the case of a controlled foreign corporation with tested income, the portion of such global intangible low-taxed income which bears the same ratio to such global intangible low-taxed income 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 described in subsection (c)(1)(A) with respect to such United States shareholder.''.

(b) FOREIGN TAX CREDIT.—

(1) APPLICATION OF DEEMED PAID FOREIGN TAX CREDIT.—Section 960 is amended adding at the end the following new subsection:

''(d) DEEMED PAID CREDIT FOR TAXES PROPERLY ATTRIBUTABLE TO TESTED INCOME.—

''(1) IN GENERAL.—For purposes of subpart A of this part, 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 the product of—

''(A) such domestic corporation's inclusion percentage, multiplied by

''(B) the aggregate tested foreign income taxes paid or accrued by controlled foreign corporations.

''(2) INCLUSION PERCENTAGE.—For purposes of paragraph (1), the term 'inclusion percentage' means, with respect to any domestic corporation, the ratio (expressed as a percentage) of—

''(A) such corporation's global intangible low-taxed income (as defined in section 951A(b)), divided by

''(B) the aggregate amount described in 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 the tested income of such foreign corporation taken into account by such domestic corporation under section 951A.".

(2) APPLICATION OF FOREIGN TAX CREDIT LIMITATION.—

(A) SEPARATE BASKET FOR GLOBAL INTANGIBLE LOW-TAXED INCOME.—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 (other than passive category income),".

(B) EXCLUSION FROM GENERAL CATEGORY INCOME.—Section 904(d)(2)(A)(ii) is amended by inserting "income described in paragraph (1)(A) and" before "passive category income".

(C) NO CARRYOVER OR CARRYBACK 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).".

(c) CLERICAL AMENDMENT.—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. Global intangible low-taxed income 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. 14202. DEDUCTION FOR FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME.

(a) IN GENERAL.—Part VIII of subchapter B of chapter 1 is amended by adding at the end the following new section:

"SEC. 250. FOREIGN-DERIVED INTANGIBLE INCOME AND GLOBAL INTANGIBLE LOW-TAXED INCOME.

"(a) ALLOWANCE OF DEDUCTION.—

"(1) IN GENERAL.—In the case of a domestic corporation for any taxable year, there shall be allowed as a deduction an amount equal to the sum of—

"(A) 37.5 percent of the foreign-derived intangible income of such domestic corporation for such taxable year, plus

"(B) 50 percent of—

"(i) the global intangible low-taxed income amount (if any) which is included in the gross income of such domestic corporation under section 951A for such taxable year, and

"(ii) the amount treated as a dividend received by such corporation under section 78 which is attributable to the amount described in clause (i).

"(2) LIMITATION BASED ON TAXABLE INCOME.—

"(A) IN GENERAL.—If, for any taxable year—

"(i) the sum of the foreign-derived intangible income and the global intangible low-taxed income amount otherwise taken into account by the domestic corporation under paragraph (1), exceeds

"(ii) the taxable income of the domestic corporation (determined without regard to this section),

then the amount of the foreign-derived intangible income and the global intangible low-taxed income amount so taken into account shall be reduced as provided in subparagraph (B).

"(B) REDUCTION.—For purposes of subparagraph (A)—

"(i) foreign-derived intangible income shall be reduced by an amount which bears the same ratio to the excess described in subparagraph (A) as such foreign-derived intangible income bears to the sum described in subparagraph (A)(i), and

"(ii) the global intangible low-taxed income amount shall be reduced by the remainder of such excess.

"(3) REDUCTION IN DEDUCTION FOR TAXABLE YEARS AFTER 2025.—In the case of any taxable year beginning after December 31, 2025, paragraph (1) shall be applied by substituting—

"(A) '21.875 percent' for '37.5 percent' in subparagraph (A), and

"(B) '37.5 percent' for '50 percent' in subparagraph (B).

"(b) FOREIGN-DERIVED INTANGIBLE INCOME.—For purposes of this section—

"(1) IN GENERAL.—The foreign-derived intangible income of any domestic corporation is the amount which bears the same ratio to the deemed intangible income of such corporation as—

"(A) the foreign-derived deduction eligible income of such corporation, bears to

"(B) the deduction eligible income of such corporation.

"(2) DEEMED INTANGIBLE INCOME.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'deemed intangible income' means the excess (if any) of—

"(i) the deduction eligible income of the domestic corporation, over

"(ii) the deemed tangible income return of the corporation.

"(B) DEEMED TANGIBLE INCOME RETURN.—The term 'deemed tangible income return' means, with respect to any corporation, an amount equal to 10 percent of the corporation's qualified business asset investment (as defined in section 951A(d), determined by substituting 'deduction eligible income' for 'tested income' in paragraph (2) thereof and without regard to whether the corporation is a controlled foreign corporation).

"(3) DEDUCTION ELIGIBLE INCOME.—

"(A) IN GENERAL.—The term 'deduction eligible income' means, with respect to any domestic corporation, the excess (if any) of—

"(i) gross income of such corporation determined without regard to—

"(I) any amount included in the gross income of such corporation under section 951(a)(1),

"(II) the global intangible low-taxed income included in the gross income of such corporation under section 951A,

"(III) any financial services income (as defined in section 904(d)(2)(D)) of such corporation,

"(IV) any dividend received from a corporation which is a controlled foreign corporation of such domestic corporation,

"(V) any domestic oil and gas extraction income of such corporation, and

"(VI) any foreign branch income (as defined in section 904(d)(2)(J)), over

"(ii) the deductions (including taxes) properly allocable to such gross income.

"(B) DOMESTIC OIL AND GAS EXTRACTION INCOME.—For purposes of subparagraph (A), the term 'domestic oil and gas extraction income' means income described in section 907(c)(1), determined by substituting 'within the United States' for 'without the United States'.

"(4) FOREIGN-DERIVED DEDUCTION ELIGIBLE INCOME.—The term 'foreign-derived deduction eligible income' means, with respect to any taxpayer for any taxable year, any deduction eligible income of such taxpayer which is derived in connection with—

"(A) property—

"(i) which is sold by the taxpayer to any person who is not a United States person, and

"(ii) which the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or

"(B) services provided by the taxpayer which the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States.

"(5) RULES RELATING TO FOREIGN USE PROPERTY OR SERVICES.—For purposes of this subsection—

"(A) FOREIGN USE.—The term 'foreign use' means any use, consumption, or disposition which is not within the United States.

"(B) PROPERTY OR SERVICES PROVIDED TO DOMESTIC INTERMEDIARIES.—

"(i) PROPERTY.—If a taxpayer sells property to another person (other than a related party) for further manufacture or other modification within the United States, such property shall not be treated as sold for a foreign use even if such other person subsequently uses such property for a foreign use.

"(ii) SERVICES.—If a taxpayer provides services to another person (other than a related party) located within the United States, such services shall not be treated as described in paragraph (4)(B) even if such other person uses such services in providing services which are so described.

"(C) SPECIAL RULES WITH RESPECT TO RELATED PARTY TRANSACTIONS.—

"(i) SALES TO RELATED PARTIES.—If property is sold to a related party who is not a United States person, such sale shall not be treated as for a foreign use unless—

"(I) such property is ultimately sold by a related party, or used by a related party in connection with property which is sold or the provision of services, to another person who is an unrelated party who is not a United States person, and

"(II) the taxpayer establishes to the satisfaction of the Secretary that such property is for a foreign use.

For purposes of this clause, a sale of property shall be treated as a sale of each of the components thereof.

"(ii) SERVICE PROVIDED TO RELATED PARTIES.—If a service is provided to a related party who is not located in the United States, such service shall not be treated described in subparagraph (A)(ii) unless the taxpayer established to the satisfaction of the Secretary that such service is not substantially similar to services provided by such related party to persons located within the United States.

"(D) RELATED PARTY.—For purposes of this paragraph, the term 'related party' means any member of 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).

Any person (other than a corporation) shall be treated as a member of such group if such person is controlled by members of such group (including any entity treated as a member of such group by reason of this sentence) or controls any such member. For purposes of the preceding sentence, control shall be determined under the rules of section 954(d)(3).

"(E) SOLD.—For purposes of this subsection, the terms 'sold', 'sells', and 'sale' shall include any lease, license, exchange, or other disposition.

"(c) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.".

(b) CONFORMING AMENDMENTS.—

(1) Section 172(d), as amended by this Act, is amended by adding at the end the following new paragraph:

"(9) DEDUCTION FOR FOREIGN-DERIVED INTANGIBLE INCOME.—The deduction under section 250 shall not be allowed.".

(2) Section 246(b)(1) is amended—

(A) by striking "and subsection (a) and (b) of section 245" the first place it appears and inserting ", subsection (a) and (b) of section 245, and section 250",

(B) by striking ''and subsection (a) and (b) of section 245'' the second place it appears and inserting ''subsection (a) and (b) of section 245, and 250''.

(3) Section 469(i)(3)(F)(iii) is amended by striking ''and 222'' and inserting ''222, and 250''.

(4) The table of sections for part VIII of subchapter B of chapter 1 is amended by adding at the end the following new item:

''Sec. 250. Foreign-derived intangible income and global intangible low-taxed income.''.

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

CHAPTER 2—OTHER MODIFICATIONS OF SUBPART F PROVISIONS

SEC. 14211. ELIMINATION OF INCLUSION OF FOREIGN BASE COMPANY OIL RELATED INCOME.

(a) REPEAL.—Subsection (a) of section 954 is amended—

(1) by inserting ''and'' at the end of paragraph (2),

(2) by striking the comma at the end of paragraph (3) and inserting a period, and

(3) by striking paragraph (5).

(b) CONFORMING AMENDMENTS.—

(1) Section 952(c)(1)(B)(iii) is amended by striking subclause (I) and redesignating subclauses (II) through (V) as subclauses (I) through (IV), respectively.

(2) Section 954(b) is amended—

(A) by striking the second sentence of paragraph (4),

(B) by striking ''the foreign base company services income, and the foreign base company oil related income'' in paragraph (5) and inserting ''and the foreign base company services income'', and

(C) by striking paragraph (6).

(3) 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 with or within which such taxable years of foreign corporations end.

SEC. 14212. 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) 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. 14213. 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) EFFECTIVE DATE.—The amendments made by this section shall apply to—

(1) the last taxable year of foreign corporations beginning before January 1, 2018, and each subsequent taxable year of such foreign corporations, and

(2) taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.

SEC. 14214. MODIFICATION OF DEFINITION OF UNITED STATES SHAREHOLDER.

(a) IN GENERAL.—Section 951(b) is amended by inserting '', or 10 percent or more of the total value of shares of all classes of stock of such foreign corporation'' after ''such foreign corporation''.

(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.

SEC. 14215. 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.

CHAPTER 3—PREVENTION OF BASE EROSION

SEC. 14221. LIMITATIONS ON INCOME SHIFTING THROUGH INTANGIBLE PROPERTY TRANSFERS.

(a) DEFINITION OF INTANGIBLE ASSET.—Section 936(h)(3)(B) is amended—

(1) by striking ''or'' at the end of clause (v),

(2) by striking clause (vi) and inserting the following:

''(vi) any goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment); or

''(vii) any other item the value or potential value of which is not attributable to tangible property or the services of any individual.'', and

(3) by striking the flush language after clause (vii), as added by paragraph (2).

(b) CLARIFICATION OF ALLOWABLE VALUATION METHODS.—

(1) FOREIGN CORPORATIONS.—Section 367(d)(2) is amended by adding at the end the following new subparagraph:

''(D) REGULATORY AUTHORITY.—For purposes of the last sentence of subparagraph (A), the Secretary shall require—

''(i) the valuation of transfers of intangible property, including intangible property transferred with other property or services, on an aggregate basis, or

''(ii) the valuation of such a transfer on the basis of the realistic alternatives to such a transfer,

if the Secretary determines that such basis is the most reliable means of valuation of such transfers.''.

(2) ALLOCATION AMONG TAXPAYERS.—Section 482 is amended by adding at the end the following: ''For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers.''.

(c) EFFECTIVE DATE.—

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

(2) NO INFERENCE.—Nothing in the amendment made by subsection (a) shall be construed to create any inference with respect to the application of section 936(h)(3) of the Internal Revenue Code of 1986, or the authority of the Secretary of the Treasury to provide regulations for such application, with respect to taxable years beginning before January 1, 2018.

SEC. 14222. CERTAIN RELATED PARTY AMOUNTS PAID OR ACCRUED IN HYBRID TRANSACTIONS OR WITH HYBRID ENTITIES.

(a) IN GENERAL.—Part IX of subchapter B of chapter 1 is amended by inserting after section 267 the following:

''SEC. 267A. CERTAIN RELATED PARTY AMOUNTS PAID OR ACCRUED IN HYBRID TRANSACTIONS OR WITH HYBRID ENTITIES.

''(a) IN GENERAL.—No deduction shall be allowed under this chapter for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity.

''(b) DISQUALIFIED RELATED PARTY AMOUNT.—For purposes of this section—

''(1) DISQUALIFIED RELATED PARTY AMOUNT.—The term 'disqualified related party amount' means any interest or royalty paid or accrued to a related party to the extent that—

''(A) such amount is not included in the income of such related party under the tax law of the country of which such related party is a resident for tax purposes or is subject to tax, or

''(B) such related party is allowed a deduction with respect to such amount under the tax law of such country.

Such term shall not include any payment to the extent such payment is included in the gross income of a United States shareholder under section 951(a).

''(2) RELATED PARTY.—The term 'related party' means a related person as defined in section 954(d)(3), except that such section shall be applied with respect to the person making the payment described in paragraph (1) in lieu of the controlled foreign corporation otherwise referred to in such section.

''(c) HYBRID TRANSACTION.—For purposes of this section, the term 'hybrid transaction' means any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for purposes of this chapter and which are not so treated for purposes the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax.

''(d) HYBRID ENTITY.—For purposes of this section, the term 'hybrid entity' means any entity which is either—

''(1) treated as fiscally transparent for purposes of this chapter but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or

''(2) treated as fiscally transparent for purposes of such tax law but not so treated for purposes of this chapter.

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

''(1) rules for treating certain conduit arrangements which involve a hybrid transaction or a hybrid entity as subject to subsection (a), *''(2) rules for the application of this section to branches or domestic entities,*

''(3) rules for treating certain structured transactions as subject to subsection (a),

''(4) rules for treating a tax preference as an exclusion from income for purposes of applying subsection (b)(1) if such tax preference has the effect of reducing the generally applicable statutory rate by 25 percent or more,

''(5) rules for treating the entire amount of interest or royalty paid or accrued to a related party as a disqualified related party amount if such amount is subject to a participation exemption system or other system which provides for the exclusion or deduction of a substantial portion of such amount,

''(6) rules for determining the tax residence of a foreign entity if the entity is otherwise considered a resident of more than one country or of no country,

''(7) exceptions from subsection (a) with respect to—

''(A) cases in which the disqualified related party amount is taxed under the laws of a foreign country other than the country of which the related party is a resident for tax purposes, and

''(B) other cases which the Secretary determines do not present a risk of eroding the Federal tax base,

''(8) requirements for record keeping and information reporting in addition to any requirements imposed by section 6038A.''.

(b) CONFORMING AMENDMENT.—The table of sections for part IX of subchapter B of chapter 1 is amended by inserting after the item relating to section 267 the following new item:

''Sec. 267A. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities.''.

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

SEC. 14223. SHAREHOLDERS OF SURROGATE FOREIGN CORPORATIONS NOT ELIGIBLE FOR REDUCED RATE ON DIVIDENDS.

(a) IN GENERAL.—Section 1(h)(11)(C)(iii) is amended—

(1) by striking ''shall not include any foreign corporation'' and inserting ''shall not include—

''(I) any foreign corporation'',

(2) by striking the period at the end and inserting '', and'', and

(3) by adding at the end the following new subclause:

''(II) any corporation which first becomes a surrogate foreign corporation (as defined in section 7874(a)(2)(B)) after the date of the enactment of this subclause, other than a foreign corporation which is treated as a domestic corporation under section 7874(b).''.

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to dividends received after the date of the enactment of this Act.

Subpart C—Modifications Related to Foreign Tax Credit System

SEC. 14301. 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, as amended by section 14201, 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 subpart A of this part, 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 subpart A of this part—

''(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 (d) (as added by section 14201) the following new subsections:

''(e) 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.

''(f) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section.''.

(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), (b), and (d) of section 960 (determined without regard to the phrase '80 percent of' in subsection (d)(1) thereof) for such taxable year shall be treated for purposes of this title (other than sections 245 and 245A) as a dividend received by such domestic corporation from the foreign corporation.''.

(2) Paragraph (4) of section 245(a) is amended to read as follows:

''(4) POST-1986 UNDISTRIBUTED EARNINGS.—The term 'post-1986 undistributed earnings' means the amount of 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—

''(A) as of the close of the taxable year of the foreign corporation in which the dividend is distributed, and

''(B) without diminution by reason of dividends distributed during such taxable year.''.

(3) Section 245(a)(10)(C) is amended by striking ''902, 907, and 960'' and inserting ''907 and 960''.

(4) Sections 535(b)(1) and 545(b)(1) are each amended by striking ''section 902(a) or 960(a)(1)'' and inserting ''section 960''.

(5) 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.—''.

(6) Section 865(h)(1)(B) is amended by striking ''902, 907,'' and inserting ''907''.

(7) Section 901(a) is amended by striking ''sections 902 and 960'' and inserting ''section 960''.

(8) 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''.

(9) Section 901(f) is amended by striking ''sections 902 and 960'' and inserting ''section 960''.

(10) Section 901(j)(1)(A) is amended by striking ''902 or''.

(11) Section 901(j)(1)(B) is amended by striking ''sections 902 and 960'' and inserting ''section 960''.

(12) Section 901(k)(2) is amended by striking '', 902,''.

(13) Section 901(k)(6) is amended by striking ''902 or''.

(14) Section 901(m)(1)(B) is amended to read as follows:

''(B) in the case of a foreign income tax paid by a foreign corporation, shall not be taken into account for purposes of section 960.''.

(15) Section 904(d)(2)(E) is amended—

(A) by amending clause (i) to read as follows:

''(i) NONCONTROLLED 10-PERCENT OWNED FOREIGN CORPORATION.—The term 'noncontrolled 10-percent owned foreign corporation' means any foreign corporation which is—

''(I) a specified 10-percent owned foreign corporation (as defined in section 245A(b)), or

''(II) a passive foreign investment company (as defined in section 1297(a)) with respect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraphs (3) and (4), the requirements of section 902(b)).

A controlled foreign corporation shall not be treated as a noncontrolled 10-percent owned foreign corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation. Any reference to section 902 in this clause shall be treated as a reference to such section as in effect before its repeal.'', and

(B) by striking ''non-controlled section 902 corporation'' in clause (ii) and inserting ''noncontrolled 10-percent owned foreign corporation''.

(16) Section 904(d)(4) is amended—

(A) by striking ''noncontrolled section 902 corporation'' each place it appears and inserting ''noncontrolled 10-percent owned foreign corporation'',

(B) by striking ''NONCONTROLLED SECTION 902 CORPORATIONS'' in the heading thereof and inserting ''NONCONTROLLED 10-PERCENT OWNED FOREIGN CORPORATIONS''.

(17) Section 904(d)(6)(A) is amended by striking ''902, 907,'' and inserting ''907''.

(18) Section 904(h)(10)(A) is amended by striking ''sections 902, 907, and 960'' and inserting ''sections 907 and 960''.

(19) Section 904(k) is amended to read as follows:

''(k) CROSS REFERENCES.—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(c).''.

(20) Section 905(c)(1) is amended by striking the last sentence.

(21) 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''.

(22) Section 906(a) is amended by striking ''(or deemed, under section 902, paid or accrued during the taxable year)''.

(23) Section 906(b) is amended by striking paragraphs (4) and (5).

(24) Section 907(b)(2)(B) is amended by striking ''902 or''.

(25) Section 907(c)(3)(A) is amended—

(A) by striking subparagraph (A) and inserting the following:

''(A) interest, to the extent the category of income of such interest is determined under section 904(d)(3),'', and

(B) by striking ''section 960(a)'' in subparagraph (B) and inserting ''section 960''.

(26) Section 907(c)(5) is amended by striking ''902 or''.

(27) Section 907(f)(2)(B)(i) is amended by striking ''902 or''.

(28) Section 908(a) is amended by striking ''902 or''.

(29) Section 909(b) is amended—

(A) by striking ''section 902 corporation'' in the matter preceding paragraph (1) and inserting ''specified 10-percent owned foreign corporation (as defined in section 245A(b) without regard to paragraph (2) thereof)'',

(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 specified 10-percent owned foreign corporation or a domestic corporation which is a United States shareholder with respect to such specified 10-percent owned foreign corporation.'', and

(D) by striking ''SECTION 902 CORPORATIONS'' in the heading thereof and inserting ''SPECIFIED 10-PERCENT OWNED FOREIGN CORPORATIONS''.

(30) Section 909(d) is amended by striking paragraph (5).

(31) Section 958(a)(1) is amended by striking ''960(a)(1)'' and inserting ''960''.

(32) Section 959(d) is amended by striking ''Except as provided in section 960(a)(3), any'' and inserting ''Any''.

(33) Section 959(e) is amended by striking ''section 960(b)'' and inserting ''section 960(c)''.

(34) 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''.

(35) Section 1293(f) is amended by striking ''and'' at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting '', and'', and by adding at the end the following new paragraph:

''(3) a domestic corporation which owns (or is treated under section 1298(a) as owning) stock of a qualified electing fund shall be treated in the same manner as a United States shareholder of a controlled foreign corporation (and such qualified electing fund shall be treated in the same manner as such controlled foreign corporation) if such domestic corporation meets the stock ownership requirements of subsection (a) or (b) of section 902 (as in effect before its repeal) with respect to such qualified electing fund.''.

(36) 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''.

(37) Section 6038(c)(4) is amended by striking subparagraph (C).

(38) 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.

(39) 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 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. 14302. SEPARATE FOREIGN TAX CREDIT LIMITATION BASKET FOR FOREIGN BRANCH INCOME.

(a) IN GENERAL.—Section 904(d)(1), as amended by section 14201, is amended by redesignating subparagraphs (B) and (C) as subparagraphs (C) and (D), respectively, and by inserting after subparagraph (A) the following new subparagraph:

''(B) foreign branch income,''.

(b) FOREIGN BRANCH INCOME.—

(1) IN GENERAL.—Section 904(d)(2) is amended by inserting after subparagraph (I) the following new subparagraph:

''(J) FOREIGN BRANCH INCOME.—

''(i) IN GENERAL.—The term 'foreign branch income' means the business profits of such United States person which are attributable to 1 or more qualified business units (as defined in section 989(a)) in 1 or more foreign countries. For purposes of the preceding sentence, the amount of business profits attributable to a qualified business unit shall be determined under rules established by the Secretary.

''(ii) EXCEPTION.—Such term shall not include any income which is passive category income.''.

(2) CONFORMING AMENDMENT.—Section 904(d)(2)(A)(ii), as amended by section 14201, is amended by striking ''income described in paragraph (1)(A) and'' and inserting ''income described in paragraph (1)(A), foreign branch income, and''.

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

SEC. 14303. 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.

SEC. 14304. ELECTION TO INCREASE PERCENTAGE OF DOMESTIC TAXABLE INCOME OFFSET BY OVERALL DOMESTIC LOSS TREATED AS FOREIGN SOURCE.

(a) IN GENERAL.—Section 904(g) is amended by adding at the end the following new paragraph:

''(5) ELECTION TO INCREASE PERCENTAGE OF TAXABLE INCOME TREATED AS FOREIGN SOURCE.—

''(A) IN GENERAL.—If any pre-2018 unused overall domestic loss is taken into account under paragraph (1) for any applicable taxable year, the taxpayer may elect to have such paragraph applied to such loss by substituting a percentage greater than 50 percent (but not greater than 100 percent) for 50 percent in subparagraph (B) thereof.

''(B) PRE-2018 UNUSED OVERALL DOMESTIC LOSS.—For purposes of this paragraph, the term 'pre-2018 unused overall domestic loss' means any overall domestic loss which—

''(i) arises in a qualified taxable year beginning before January 1, 2018, and

''(ii) has not been used under paragraph (1) for any taxable year beginning before such date.

''(C) APPLICABLE TAXABLE YEAR.—For purposes of this paragraph, the term 'applicable taxable year' means any taxable year of the taxpayer beginning after December 31, 2017, and before January 1, 2028.''.

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

PART II—INBOUND TRANSACTIONS

SEC. 14401. BASE EROSION AND ANTI-ABUSE TAX.

(a) IMPOSITION OF TAX.—Subchapter A of chapter 1 is amended by adding at the end the following new part:

''PART VII—BASE EROSION AND ANTI-ABUSE TAX

''Sec. 59A. Tax on base erosion payments of taxpayers with substantial gross receipts.

''SEC. 59A. TAX ON BASE EROSION PAYMENTS OF TAXPAYERS WITH SUBSTANTIAL GROSS RECEIPTS.

''(a) IMPOSITION OF TAX.—There is hereby imposed on each applicable taxpayer for any taxable year a tax equal to the base erosion minimum tax amount for the taxable year. Such tax shall be in addition to any other tax imposed by this subtitle.

''(b) BASE EROSION MINIMUM TAX AMOUNT.—For purposes of this section—

''(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the term 'base erosion minimum tax amount' means, with respect to any applicable taxpayer for any taxable year, the excess (if any) of—

''(A) an amount equal to 10 percent (5 percent in the case of taxable years beginning in calendar year 2018) of the modified taxable income of such taxpayer for the taxable year, over

''(B) an amount equal to the regular tax liability (as defined in section 26(b)) of the taxpayer for the taxable year, reduced (but not below zero) by the excess (if any) of—

''(i) the credits allowed under this chapter against such regular tax liability, over

''(ii) the sum of—

''(I) the credit allowed under section 38 for the taxable year which is properly allocable to the research credit determined under section 41(a), plus

''(II) the portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this subclause).

''(2) MODIFICATIONS FOR TAXABLE YEARS BEGINNING AFTER 2025.—In the case of any taxable year beginning after December 31, 2025, paragraph (1) shall be applied—

''(A) by substituting '12.5 percent' for '10 percent' in subparagraph (A) thereof, and

''(B) by reducing (but not below zero) the regular tax liability (as defined in section 26(b)) for purposes of subparagraph (B) thereof by the aggregate amount of the credits allowed under this chapter against such regular tax liability rather than the excess described in such subparagraph.

''(3) INCREASED RATE FOR CERTAIN BANKS AND SECURITIES DEALERS.—

''(A) IN GENERAL.—In the case of a taxpayer described in subparagraph (B) who is an applicable taxpayer for any taxable year, the percentage otherwise in effect under paragraphs (1)(A) and (2)(A) shall each be increased by one percentage point.

''(B) TAXPAYER DESCRIBED.—A taxpayer is described in this subparagraph if such taxpayer is a member of an affiliated group (as defined in section 1504(a)(1)) which includes—

''(i) a bank (as defined in section 581), or

''(ii) a registered securities dealer under section 15(a) of the Securities Exchange Act of 1934.

''(4) APPLICABLE SECTION 38 CREDITS.—For purposes of paragraph (1)(B)(ii)(II), the term 'applicable section 38 credits' means the credit allowed under section 38 for the taxable year which is properly allocable to—

''(A) the low-income housing credit determined under section 42(a),

''(B) the renewable electricity production credit determined under section 45(a), and

''(C) the investment credit determined under section 46, but only to the extent properly allocable to the energy credit determined under section 48.

''(c) MODIFIED TAXABLE INCOME.—For purposes of this section—

''(1) IN GENERAL.—The term 'modified taxable income' means the taxable income of the taxpayer computed under this chapter for the taxable year, determined without regard to—

''(A) any base erosion tax benefit with respect to any base erosion payment, or

''(B) the base erosion percentage of any net operating loss deduction allowed under section 172 for the taxable year.

''(2) BASE EROSION TAX BENEFIT.—

''(A) IN GENERAL.—The term 'base erosion tax benefit' means—

''(i) any deduction described in subsection (d)(1) which is allowed under this chapter for the taxable year with respect to any base erosion payment,

''(ii) in the case of a base erosion payment described in subsection (d)(2), any deduction allowed under this chapter for the taxable year for depreciation (or amortization in lieu of depreciation) with respect to the property acquired with such payment,

''(iii) in the case of a base erosion payment described in subsection (d)(3)—

''(I) any reduction under section 803(a)(1)(B) in the gross amount of premiums and other consideration on insurance and annuity contracts for premiums and other consideration arising out of indemnity insurance, and

''(II) any deduction under section 832(b)(4)(A) from the amount of gross premiums written on insurance contracts during the taxable year for premiums paid for reinsurance, and

''(iv) in the case of a base erosion payment described in subsection (d)(4), any reduction in gross receipts with respect to such payment in computing gross income of the taxpayer for the taxable year for purposes of this chapter.

''(B) TAX BENEFITS DISREGARDED IF TAX WITHHELD ON BASE EROSION PAYMENT.—

''(i) IN GENERAL.—Except as provided in clause (ii), any base erosion tax benefit attributable to any base erosion payment—

''(I) on which tax is imposed by section 871 or 881, and

''(II) with respect to which tax has been deducted and withheld under section 1441 or 1442, shall not be taken into account in computing modified taxable income under paragraph (1)(A) or the base erosion percentage under paragraph (4).

''(ii) EXCEPTION.—The amount not taken into account in computing modified taxable income by reason of clause (i) shall be reduced under rules similar to the rules under section 163(j)(5)(B) (as in effect before the date of the enactment of the Tax Cuts and Jobs Act).

''(3) SPECIAL RULES FOR DETERMINING INTEREST FOR WHICH DEDUCTION ALLOWED.—For purposes of applying paragraph (1), in the case of a taxpayer to which section 163(j) applies for the taxable year, the reduction in the amount of interest for which a deduction is allowed by reason of such subsection shall be treated as allocable first to interest paid or accrued to persons who are not related parties with respect to the taxpayer and then to such related parties.

''(4) BASE EROSION PERCENTAGE.—For purposes of paragraph (1)(B)—

''(A) IN GENERAL.—The term 'base erosion percentage' means, for any taxable year, the percentage determined by dividing—

''(i) the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year, by

''(ii) the sum of—

''(I) the aggregate amount of the deductions (including deductions described in clauses (i) and (ii) of paragraph (2)(A)) allowable to the taxpayer under this chapter for the taxable year, plus

''(II) the base erosion tax benefits described in clauses (iii) and (iv) of paragraph (2)(A) allowable to the taxpayer for the taxable year.

''(B) CERTAIN ITEMS NOT TAKEN INTO ACCOUNT.—The amount under subparagraph (A)(ii) shall be determined by not taking into account—

''(i) any deduction allowed under section 172, 245A, or 250 for the taxable year,

''(ii) any deduction for amounts paid or accrued for services to which the exception under subsection (d)(5) applies, and

''(iii) any deduction for qualified derivative payments which are not treated as a base erosion payment by reason of subsection (h).

''(d) BASE EROSION PAYMENT.—For purposes of this section—

''(1) IN GENERAL.—The term 'base erosion payment' means any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer and with respect to which a deduction is allowable under this chapter.

''(2) PURCHASE OF DEPRECIABLE PROPERTY.—Such term shall also include any amount paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer in connection with the acquisition by the taxpayer from such person of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation).

''(3) REINSURANCE PAYMENTS.—Such term shall also include any premium or other consideration paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer for any reinsurance payments which are taken into account under sections 803(a)(1)(B) or 832(b)(4)(A).

''(4) CERTAIN PAYMENTS TO EXPATRIATED ENTITIES.—

''(A) IN GENERAL.—Such term shall also include any amount paid or accrued by the taxpayer with respect to a person described in subparagraph (B) which results in a reduction of the gross receipts of the taxpayer.

''(B) PERSON DESCRIBED.—A person is described in this subparagraph if such person is a—

''(i) surrogate foreign corporation which is a related party of the taxpayer, but only if such person first became a surrogate foreign corporation after November 9, 2017, or

''(ii) foreign person which is a member of the same expanded affiliated group as the surrogate foreign corporation.

''(C) DEFINITIONS.—For purposes of this paragraph—

''(i) SURROGATE FOREIGN CORPORATION.—The term 'surrogate foreign corporation' has the meaning given such term by section 7874(a)(2)(B) but does not include a foreign corporation treated as a domestic corporation under section 7874(b).

''(ii) EXPANDED AFFILIATED GROUP.—The term 'expanded affiliated group' has the meaning given such term by section 7874(c)(1).

''(5) EXCEPTION FOR CERTAIN AMOUNTS WITH RESPECT TO SERVICES.—Paragraph (1) shall not apply to any amount paid or accrued by a taxpayer for services if—

''(A) such services are services which meet the requirements for eligibility for use of the services cost method under section 482 (determined without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure), and

''(B) such amount constitutes the total services cost with no markup component.

''(e) APPLICABLE TAXPAYER.—For purposes of this section—

''(1) IN GENERAL.—The term 'applicable taxpayer' means, with respect to any taxable year, a taxpayer—

''(A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation,

''(B) the average annual gross receipts of which for the 3-taxable-year period ending with the preceding taxable year are at least $500,000,000, and

''(C) the base erosion percentage (as determined under subsection (c)(4)) of which for the taxable year is 3 percent (2 percent in the case of a taxpayer described in subsection (b)(3)(B)) or higher.

''(2) GROSS RECEIPTS.—

''(A) SPECIAL RULE FOR FOREIGN PERSONS.—In the case of a foreign person the gross receipts of which are taken into account for purposes of paragraph (1)(B), only gross receipts which are taken into account in determining income which is effectively connected with the conduct of a trade or business within the United States shall be taken into account. In the case of a taxpayer which is a foreign person, the preceding sentence shall not apply to the gross receipts of any United States person which are aggregated with the taxpayer's gross receipts by reason of paragraph (3).

''(B) OTHER RULES MADE APPLICABLE.—Rules similar to the rules of subparagraphs (B), (C), and (D) of section 448(c)(3) shall apply in determining gross receipts for purposes of this section.

''(3) AGGREGATION RULES.—All persons treated as a single employer under subsection (a) of section 52 shall be treated as 1 person for purposes of this subsection and subsection (c)(4), except that in applying section 1563 for purposes of section 52, the exception for foreign corporations under section 1563(b)(2)(C) shall be disregarded.

''(f) FOREIGN PERSON.—For purposes of this section, the term 'foreign person' has the meaning given such term by section 6038A(c)(3).

''(g) RELATED PARTY.—For purposes of this section—

''(1) IN GENERAL.—The term 'related party' means, with respect to any applicable taxpayer—

''(A) any 25-percent owner of the taxpayer,

''(B) any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer or any 25-percent owner of the taxpayer, and

''(C) any other person who is related (within the meaning of section 482) to the taxpayer.

''(2) 25-PERCENT OWNER.—The term '25-percent owner' means, with respect to any corporation, any person who owns at least 25 percent of—

''(A) the total voting power of all classes of stock of a corporation entitled to vote, or

''(B) the total value of all classes of stock of such corporation.

''(3) SECTION 318 TO APPLY.—Section 318 shall apply for purposes of paragraphs (1) and (2), except that—

''(A) '10 percent' shall be substituted for '50 percent' in section 318(a)(2)(C), and

''(B) subparagraphs (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person.

''(h) EXCEPTION FOR CERTAIN PAYMENTS MADE IN THE ORDINARY COURSE OF TRADE OR BUSINESS.—For purposes of this section—

''(1) IN GENERAL.—Except as provided in paragraph (3), any qualified derivative payment shall not be treated as a base erosion payment.

''(2) QUALIFIED DERIVATIVE PAYMENT.—

''(A) IN GENERAL.—The term 'qualified derivative payment' means any payment made by a taxpayer pursuant to a derivative with respect to which the taxpayer—

''(i) recognizes gain or loss as if such derivative were sold for its fair market value on the last business day of the taxable year (and such additional times as required by this title or the taxpayer's method of accounting),

''(ii) treats any gain or loss so recognized as ordinary, and

''(iii) treats the character of all items of income, deduction, gain, or loss with respect to a payment pursuant to the derivative as ordinary.

''(B) REPORTING REQUIREMENT.—No payments shall be treated as qualified derivative payments under subparagraph (A) for any taxable year unless the taxpayer includes in the information required to be reported under section 6038B(b)(2) with respect to such taxable year such information as is necessary to identify the payments to be so treated and such other information as the Secretary determines necessary to carry out the provisions of this subsection.

''(3) EXCEPTIONS FOR PAYMENTS OTHERWISE TREATED AS BASE EROSION PAYMENTS.—This subsection shall not apply to any qualified derivative payment if—

''(A) the payment would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment, or

''(B) in the case of a contract which has derivative and nonderivative components, the payment is properly allocable to the nonderivative component.

''(4) DERIVATIVE DEFINED.—For purposes of this subsection—

''(A) IN GENERAL.—The term 'derivative' means any contract (including any option, forward contract, futures contract, short position, swap, or similar contract) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to one or more of the following:

''(i) Any share of stock in a corporation.

''(ii) Any evidence of indebtedness.

''(iii) Any commodity which is actively traded.

''(iv) Any currency.

''(v) Any rate, price, amount, index, formula, or algorithm.

Such term shall not include any item described in clauses (i) through (v).

''(B) TREATMENT OF AMERICAN DEPOSITORY RECEIPTS AND SIMILAR INSTRUMENTS.—Except as otherwise provided by the Secretary, for purposes of this part, American depository receipts (and similar instruments) with respect to shares of stock in foreign corporations shall be treated as shares of stock in such foreign corporations.

''(C) EXCEPTION FOR CERTAIN CONTRACTS.—Such term shall not include any insurance, annuity, or endowment contract issued by an insurance company to which subchapter L applies (or issued by any foreign corporation to which such subchapter would apply if such foreign corporation were a domestic corporation).

''(i) REGULATIONS.—The Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate to carry out the provisions of this section, including regulations—

''(1) providing for such adjustments to the application of this section as are necessary to prevent the avoidance of the purposes of this section, including through—

''(A) the use of unrelated persons, conduit transactions, or other intermediaries, or

''(B) transactions or arrangements designed, in whole or in part—

''(i) to characterize payments otherwise subject to this section as payments not subject to this section, or

''(ii) to substitute payments not subject to this section for payments otherwise subject to this section and

''(2) for the application of subsection (g), including rules to prevent the avoidance of the exceptions under subsection (g)(3).''.

(b) REPORTING REQUIREMENTS AND PENALTIES.—

(1) IN GENERAL.—Subsection (b) of section 6038A is amended to read as follows:

''(b) REQUIRED INFORMATION.—

''(1) IN GENERAL.—For purposes of subsection (a), the information described in this subsection is such information as the Secretary prescribes by regulations relating to—

''(A) the name, principal place of business, nature of business, and country or countries in which organized or resident, of each person which—

''(i) is a related party to the reporting corporation, and

''(ii) had any transaction with the reporting corporation during its taxable year,

''(B) the manner in which the reporting corporation is related to each person referred to in subparagraph (A), and

''(C) transactions between the reporting corporation and each foreign person which is a related party to the reporting corporation.

''(2) ADDITIONAL INFORMATION REGARDING BASE EROSION PAYMENTS.—For purposes of subsection (a) and section 6038C, if the reporting corporation or the foreign corporation to whom section 6038C applies is an applicable taxpayer, the information described in this subsection shall include—

''(A) such information as the Secretary determines necessary to determine the base erosion minimum tax amount, base erosion payments, and base erosion tax benefits of the taxpayer for purposes of section 59A for the taxable year, and

''(B) such other information as the Secretary determines necessary to carry out such section. For purposes of this paragraph, any term used in this paragraph which is also used in section 59A shall have the same meaning as when used in such section.''.

(2) INCREASE IN PENALTY.—Paragraphs (1) and (2) of section 6038A(d) are each amended by striking ''$10,000'' and inserting ''$25,000''.

(c) DISALLOWANCE OF CREDITS AGAINST BASE EROSION TAX.—Paragraph (2) of section 26(b) is amended by inserting after subparagraph (A) the following new subparagraph:

''(B) section 59A (relating to base erosion and anti-abuse tax),''.

(d) CONFORMING AMENDMENTS.—

(1) The table of parts for subchapter A of chapter 1 is amended by adding after the item relating to part VI the following new item:

''PART VII. BASE EROSION AND ANTI-ABUSE TAX''.

(2) Paragraph (1) of section 882(a), as amended by this Act, is amended by inserting '' or 59A,'' after ''section 11,''.

(3) Subparagraph (A) of section 6425(c)(1), as amended by section 13001, is amended to read as follows:

''(A) the sum of—

''(i) the tax imposed by section 11, or subchapter L of chapter 1, whichever is applicable, plus

''(ii) the tax imposed by section 59A, over''.

(4)(A) Subparagraph (A) of section 6655(g)(1), as amended by sections 12001 and 13001, is amended by striking ''plus'' at the end of clause (i), by redesignating clause (ii) as clause (iii), and by inserting after clause (i) the following new clause:

''(ii) the tax imposed by section 59A, plus''.

(B) Subparagraphs (A)(i) and (B)(i) of section 6655(e)(2), as amended by sections 12001 and 13001, are each amended by inserting ''and modified taxable income'' after ''taxable income''.

(C) Subparagraph (B) of section 6655(e)(2) is amended by adding at the end the following new clause:

''(iii) MODIFIED TAXABLE INCOME.—The term 'modified taxable income' has the meaning given such term by section 59A(c)(1).''.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to base erosion payments (as defined in section 59A(d) of the Internal Revenue Code of 1986, as added by this section) paid or accrued in taxable years beginning after December 31, 2017.

PART III—OTHER PROVISIONS

SEC. 14501. 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.

SEC. 14502. REPEAL OF FAIR MARKET VALUE METHOD OF INTEREST EXPENSE APPORTIONMENT.

(a) IN GENERAL.—Paragraph (2) of section 864(e) is amended to read as follows:

''(2) GROSS INCOME AND FAIR MARKET VALUE METHODS MAY NOT BE USED FOR INTEREST.—All allocations and apportionments of interest expense shall be determined using the adjusted bases of assets rather than on the basis of the fair market value of the assets or gross income.''.

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

TITLE II

SEC. 20001. OIL AND GAS PROGRAM.

(a) DEFINITIONS.—In this section:

(1) COASTAL PLAIN.—The term ''Coastal Plain'' means the area identified as the 1002 Area on the plates prepared by the United States Geological Survey entitled ''ANWR Map – Plate 1'' and ''ANWR Map – Plate 2'', dated October 24, 2017, and on file with the United States

Geological Survey and the Office of the Solicitor of the Department of the Interior.

(2) SECRETARY.—The term ''Secretary'' means the Secretary of the Interior, acting through the Bureau of Land Management.

(b) OIL AND GAS PROGRAM.—

(1) IN GENERAL.—Section 1003 of the Alaska National Interest Lands Conservation Act (16 U.S.C. 3143) shall not apply to the Coastal Plain.

(2) ESTABLISHMENT.—

(A) IN GENERAL.—The Secretary shall establish and administer a competitive oil and gas program for the leasing, development, production, and transportation of oil and gas in and from the Coastal Plain.

(B) PURPOSES.—Section 303(2)(B) of the Alaska National Interest Lands Conservation Act (Public Law 96–487; 94 Stat. 2390) is amended—

(i) in clause (iii), by striking ''and'' at the end;

(ii) in clause (iv), by striking the period at the end and inserting ''; and''; and

(iii) by adding at the end the following:

''(v) to provide for an oil and gas program on the Coastal Plain.''.

(3) MANAGEMENT.—Except as otherwise provided in this section, the Secretary shall manage the oil and gas program on the Coastal Plain in a manner similar to the administration of lease sales under the Naval Petroleum Reserves Production Act of 1976 (42 U.S.C. 6501 et seq.) (including regulations).

(4) ROYALTIES.—Notwithstanding the Mineral Leasing Act (30 U.S.C. 181 et seq.), the royalty rate for leases issued pursuant to this section shall be 16.67 percent.

(5) RECEIPTS.—Notwithstanding the Mineral Leasing Act (30 U.S.C. 181 et seq.), of the amount of adjusted bonus, rental, and royalty receipts derived from the oil and gas program and operations on Federal land authorized under this section—

(A) 50 percent shall be paid to the State of Alaska; and

(B) the balance shall be deposited into the Treasury as miscellaneous receipts.

(c) 2 LEASE SALES WITHIN 10 YEARS.—

(1) REQUIREMENT.—

(A) IN GENERAL.—Subject to subparagraph (B), the Secretary shall conduct not fewer than 2 lease sales area-wide under the oil and gas program under this section by not later than 10 years after the date of enactment of this Act.

(B) SALE ACREAGES; SCHEDULE.—

(i) ACREAGES.—The Secretary shall offer for lease under the oil and gas program under this section—

(I) not fewer than 400,000 acres area-wide in each lease sale; and

(II) those areas that have the highest potential for the discovery of hydrocarbons.

(ii) SCHEDULE.—The Secretary shall offer—

(I) the initial lease sale under the oil and gas program under this section not later than 4 years after the date of enactment of this Act; and

(II) a second lease sale under the oil and gas program under this section not later than 7 years after the date of enactment of this Act.

(2) RIGHTS-OF-WAY.—The Secretary shall issue any rights-of-way or easements across the Coastal Plain for the exploration, development, production, or transportation necessary to carry out this section.

(3) SURFACE DEVELOPMENT.—In administering this section, the Secretary shall authorize up to 2,000 surface acres of Federal land on the Coastal Plain to be covered by production and support facilities (including airstrips and any area covered by gravel berms or piers for support of pipelines) during the term of the leases under the oil and gas program under this section.

SEC. 20002. LIMITATIONS ON AMOUNT OF DISTRIBUTED QUALIFIED OUTER CONTINENTAL SHELF REVENUES.

Section 105(f)(1) of the Gulf of Mexico Energy Security Act of 2006 (43 U.S.C. 1331 note; Public Law 109–432) is amended by striking ''exceed $500,000,000 for each of fiscal years 2016 through 2055.'' and inserting the following: ''exceed—

''(A) $500,000,000 for each of fiscal years 2016 through 2019;

''(B) $650,000,000 for each of fiscal years 2020 and 2021; and

''(C) $500,000,000 for each of fiscal years 2022 through 2055.''.

SEC. 20003. STRATEGIC PETROLEUM RESERVE DRAWDOWN AND SALE.

(a) DRAWDOWN AND SALE.—

(1) IN GENERAL.—Notwithstanding section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241), except as provided in subsections (b) and (c), the Secretary of Energy shall draw down and sell from the Strategic Petroleum Reserve 7,000,000 barrels of crude oil during the period of fiscal years 2026 through 2027.

(2) DEPOSIT OF AMOUNTS RECEIVED FROM SALE.—Amounts received from a sale under paragraph (1) shall be deposited in the general fund of the Treasury during the fiscal year in which the sale occurs.

(b) EMERGENCY PROTECTION.—The Secretary of Energy shall not draw down and sell crude oil under subsection (a) in a quantity that would limit the authority to sell petroleum products under subsection (h) of section 161 of the Energy Policy and Conservation Act (42 U.S.C. 6241) in the full quantity authorized by that subsection.

(c) LIMITATION.—The Secretary of Energy shall not drawdown or conduct sales of crude oil under subsection (a) after the date on which a total of $600,000,000 has been deposited in the general fund of the Treasury from sales authorized under that subsection.

And the Senate agree to the same.

From the Committee on Ways and Means, for consideration of the House bill and the Senate amendment, and modifications committed to conference:

KEVIN BRADY,
DEVIN NUNES,
PETER J. ROSKAM,
DIANE BLACK,
KRISTI L. NOEM,

From the Committee on Energy and Commerce, for consideration of sec. 20003 of the Senate amendment, and modifications committed to conference:

FRED UPTON,
JOHN SHIMKUS,

From the Committee on Natural Resources, for consideration of secs. 20001 and 20002 of the Senate amendment, and modifications committed to conference:

ROB BISHOP,
DON YOUNG,

Managers on the Part of the House.

ORRIN G. HATCH,
MICHAEL B. ENZI,
LISA MURKOWSKI,
JOHN CORNYN,
JOHN THUNE,
ROB PORTMAN,
TIM SCOTT,
PATRICK J. TOOMEY,

Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 1), the Tax Cuts and Jobs Act, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment that is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clarifying changes.

TITLE I

INDIVIDUAL TAX PROVISIONS

A. Reduction and Simplification of Individual Income Tax Rates (sec. 1001 of the House bill, sec. 11001 of the Senate amendment, 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
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 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]

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-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.

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

[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(e)(2).
[5] Sec. 1(h).
[6] Sec. 3.02 of Rev. Proc. 2016–55, *supra*.
[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).

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.

HOUSE BILL

Modification of rates

The House bill replaces the individual income tax rate structure with a new rate structure.

TABLE 2.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE HOUSE BILL

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 dollar amounts for bracket thresholds are all adjusted for inflation and then rounded to the next lowest multiple of $100 in future years.[12] Unlike present law, which uses a measure of the Consumer Price Index for All Urban Consumers ("CPI–U"), the new inflation adjustment uses the Chained Consumer Price Index for All Urban Consumers ("C–CPI–U").

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 ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child. Thus, as under present law, taxable income attributable to earned income is taxed according to an unmarried taxpayers' brackets and rates. Taxable income attributable to net unearned income is taxed according to the brackets applicable to trusts and estates, with respect to both ordinary income and income taxed at preferential rates. Thus, under the provision, the child's tax is unaffected by the tax situation of the child's parent or the unearned income of any siblings.

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 based on 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, such gain 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 applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

Temporary modification of rates

The Senate amendment temporarily replaces the individual income tax rate structure with a new rate structure.

TABLE 3.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE SENATE AMENDMENT

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700.	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $70,000.	$4,453.50 plus 22% of the excess over $38,700
Over $70,000 but not over $160,000.	$11,339.50 plus 24% of the excess over $70,000
Over $160,000 but not over $200,000.	$32,939.50 plus 32% of the excess over $160,000
Over $200,000 but not over $500,000.	$45,739.50 plus 35% of the excess over $200,000
Over $500,000	$150,739.50 plus 38.5% of the excess over $500,000
Heads of Households	
Not over $13,600	10% of the taxable income
Over $13,600 but not over $51,800.	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $70,000.	$5,944 plus 22% of the excess over $51,800
Over $70,000 but not over $160,000.	$9,948 plus 24% of the excess over $70,000
Over $160,000 but not over $200,000.	$31,548 plus 32% of the excess over $160,000
Over $200,000 but not over $500,000.	$44,348 plus 35% of the excess over $200,000
Over $500,000	$149,348 plus 38.5% of the excess over $500,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400.	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $140,000.	$8,907 plus 22% of the excess over $77,400
Over $140,000 but not over $320,000.	$22,679 plus 24% of the excess over $140,000
Over $320,000 but not over $400,000.	$65,879 plus 32% of the excess over $320,000
Over $400,000 but not over $1,000,000.	$91,479 plus 35% of the excess over $400,000
Over $1,000,000	$301,479 plus 38.5% of the excess over $1,000,000
Married Individuals Filing Separate Returns	
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700.	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $70,000.	$4,453.50 plus 22% of the excess over $38,700
Over $70,000 but not over $160,000.	$11,339.50 plus 24% of the excess over $70,000
Over $160,000 but not over $200,000.	$32,939.50 plus 32% of the excess over $160,000
Over $200,000 but not over $500,000.	$45,739.50 plus 35% of the excess over $200,000
Over $500,000	$150,739.50 plus 38.5% of the excess over $500,000
Estates and Trusts	
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150.	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500.	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 38.5% of the excess over $12,500

Unlike present law, which uses a measure of the CPI–U, the new inflation adjustment uses the C–CPI–U.

The provision's rate structure does not apply to taxable years beginning after December 31, 2025.

Temporary simplification of tax on unearned income of children

The Senate amendment follows the House bill in applying ordinary and capital gains rates applicable to trusts and estates to the net unearned income of a child, but does not apply these changes to taxable years beginning after December 31, 2025.

Maximum rates on capital gains and qualified dividends

The Senate amendment follows the House bill and generally retains the present-law maximum rates on net capital gain and qualified dividends.

Paid preparer due diligence requirement for head of household status

The Senate amendment directs the Secretary of the Treasury to promulgate due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household. A penalty of $500 is imposed for each failure to meet these requirements.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement temporarily replaces the existing rate structure with a new rate structure.

[12] Some thresholds are defined as 1/2 of dollar amounts and thus may be multiples of $50.

TABLE 4.—FEDERAL INDIVIDUAL INCOME TAX RATES FOR 2018 UNDER THE CONFERENCE AGREEMENT

If taxable income is:	then income tax equals:
Single Individuals	
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700.	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500.	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500.	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000.	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000.	$45,689.50 plus 35% of the excess over $200,000
Over $500,000	$150,689.50 plus 37% of the excess over $500,000
Heads of Households	
Not over $13,600	10% of the taxable income
Over $13,600 but not over $51,800.	$1,360 plus 12% of the excess over $13,600
Over $51,800 but not over $82,500.	$5,944 plus 22% of the excess over $51,800
Over $82,500 but not over $157,500.	$12,698 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000.	$30,698 plus 32% of the excess over $157,500
Over $200,000 but not over $500,000.	$44,298 plus 35% of the excess over $200,000
Over $500,000	$149,298 plus 37% of the excess over $500,000
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $19,050	10% of the taxable income
Over $19,050 but not over $77,400.	$1,905 plus 12% of the excess over $19,050
Over $77,400 but not over $165,000.	$8,907 plus 22% of the excess over $77,400
Over $165,000 but not over $315,000.	$28,179 plus 24% of the excess over $165,000
Over $315,000 but not over $400,000.	$64,179 plus 32% of the excess over $315,000
Over $400,000 but not over $600,000.	$91,379 plus 35% of the excess over $400,000
Over $600,000	$161,379 plus 37% of the excess over $600,000
Married Individuals Filing Separate Returns	
Not over $9,525	10% of the taxable income
Over $9,525 but not over $38,700.	$952.50 plus 12% of the excess over $9,525
Over $38,700 but not over $82,500.	$4,453.50 plus 22% of the excess over $38,700
Over $82,500 but not over $157,500.	$14,089.50 plus 24% of the excess over $82,500
Over $157,500 but not over $200,000.	$32,089.50 plus 32% of the excess over $157,500
Over $200,000 but not over $300,000.	$45,689.50 plus 35% of the excess over $200,000
Over $300,000	$80,689.50 plus 37% of the excess over $300,000
Estates and Trusts	
Not over $2,550	10% of the taxable income
Over $2,550 but not over $9,150.	$255 plus 24% of the excess over $2,550
Over $9,150 but not over $12,500.	$1,839 plus 35% of the excess over $9,150
Over $12,500	$3,011.50 plus 37% of the excess over $12,500

The provision's rate structure does not apply to taxable years beginning after December 31, 2025.

The conference agreement does not follow the House bill in phasing out the 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 conference agreement follows the House bill and generally retains present-law maximum rates on net capital gains and qualified dividends.

The conference agreement follows the House bill in simplifying the tax on the unearned income of children. This provision does not apply to taxable years beginning after December 31, 2025.

The conference agreement follows the Senate amendment and directs the Secretary of the Treasury to promulgate due diligence requirements for paid preparers in determining eligibility for a taxpayer to file as head of household.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

1. Increase in standard deduction (sec. 1002 of the House bill, sec. 11021 of the Senate amendment, and sec. 63 of the Code)

PRESENT LAW

Under present law, an individual who does not elect to itemize deductions may reduce his or her adjusted gross income (''AGI'') by the amount of the applicable standard deduction in arriving at his or her 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.

HOUSE BILL

The House bill 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 C–CPI–U 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.

SENATE AMENDMENT

The Senate amendment temporarily increases the basic standard deduction for individuals across all filing statuses. Under the provision, the amount of the standard deduction is temporarily increased to $24,000 for married individuals filing a joint return, $18,000 for head-of-household filers, and $12,000 for all other individuals. The amount of the standard deduction is indexed for inflation using the C–CPI–U for taxable years beginning after December 31, 2018.

The additional standard deduction for the elderly and the blind is not changed by the provision.

The increase of the basic standard deduction does not apply to taxable years beginning after December 31, 2025.[15]

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

[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 deductions, for a total additional amount (for 2017) of $2,500 or $3,100, as applicable.

[14] Thus, the standard deduction is the same for 2018 and 2019.

[15] The standard deduction continues to be indexed with the C–CPI–U after this sunset.

2. Repeal of the deduction for personal exemptions (sec. 1003 of the House bill, sec. 11041 of the Senate amendment, and sec. 151 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 married taxpayers filing jointly, $287,650 for heads of household, $156,900 for married taxpayers filing separately, 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 additional 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.

HOUSE BILL

The House bill 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.

SENATE AMENDMENT

The Senate amendment suspends the deduction for personal exemptions.[16]

The Senate amendment follows the House bill in modifying the requirements for those who are required to file a tax return.

The provision does not apply to taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment and suspends the deduction for personal exemptions. The suspension does not apply to taxable years beginning after December 31, 2025.

The conference agreement generally follows the House bill in modifying the withholding rules to reflect that taxpayers no longer claim personal exemptions under the conference agreement.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017. The conference agreement provides that the Secretary may administer the withholding rules under section 3402 for taxable years beginning before January 1, 2019, without regard to the amendments made under this provision. Thus, at the Secretary's discretion, wage withholding rules may remain the same as under present law for 2018.

3. Alternative inflation adjustment (secs. 1001 and 1005 of the House bill, sec. 11002 of the Senate amendment, and sec. 1 of the Code)

PRESENT LAW

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'').[17] 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.

HOUSE BILL

The House bill requires the use of the Chained Consumer Price Index for All Urban Consumers (''C–CPI–U'') to adjust 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.

Under the provision, indexed parameters in the Code switch from CPI–U indexing to C–CPI–U indexing going forward in taxable years beginning after December 31, 2017. Therefore, in the case of any existing tax parameters that are not reset for 2018, the provision indexes parameters as if CPI–U applies through 2017 and C–CPI–U applies for years thereafter; the provision does not index all existing tax parameters from their base years using the C–CPI–U. Tax parameters with cost-of-living adjustment base years of 2016 and later are indexed solely with C–CPI–U. Therefore, tax values that are reset for 2018 are indexed by the C–CPI–U in taxable years beginning after December 31, 2018.[18]

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment generally follows the House bill.[19]

The provision requiring C–CPI–U indexing after 2017 is permanent. Thus, after certain temporary tax parameters sunset, such as bracket thresholds and the increased basic standard deduction, corresponding present law values in the Code are indexed appropriately with the C–CPI–U.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

B. Treatment of Business Income of Individuals, Trusts, and Estates

1. Deduction for qualified business income (sec. 1004 of the House bill, sec. 11011 of the Senate amendment, and sec. 199A 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.

Partnerships

Partnerships generally are treated for Federal income tax purposes as pass-through entities not subject to tax at the entity level.[20] 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).[21] A partner's deduction for partnership losses is limited to the partner's adjusted basis in its partnership interest.[22] 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.[23] Partners generally may receive distributions of partnership property without recognition of gain or loss, subject to some exceptions.[24]

Partnerships may allocate items of income, gain, loss, deduction, and credit among the partners, provided the allocations have substantial economic effect.[25] 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 amounts to be received by the partners from the partnership independent of tax consequences.[26]

State laws of every State provide for limited liability companies[27] (''LLCs''), which are neither partnerships nor corporations under applicable State law, but which are generally treated as partnerships for Federal tax purposes.[28]

Under present law, a publicly traded partnership generally is treated as a corporation for Federal tax purposes.[29] For this purpose,

[16] The provision also clarifies that, for purposes of taxable years in which the personal exemption is reduced to zero, this should not alter the operation of those provisions of the Code which refer to a taxpayer allowed a deduction (or an individual with respect to whom a taxpayer is allowed a deduction) under section 151. Thus, for instance, sec. 24(a) allows a credit against tax with respect to each qualifying child of the taxpayer for which the taxpayer is allowed a deduction under section 151. A qualifying child, as defined under section 152(c), remains eligible for the credit, notwithstanding that the deduction under section 151 has been reduced to zero.

[17] Generally, the Code adjusts calendar year values for cost of living by using the percentage by which the price index for the preceding calendar year exceeds the price index for a base calendar year. Sec. 1(f).

[18] One exception is the increased standard deduction which is indexed by C–CPI–U in taxable years beginning after December 31, 2019 and therefore is the same in 2018 and 2019.

[19] The Senate Amendment indexes all tax values that are temporarily reset for 2018, including the basic standard deduction, with the C–CPI–U in taxable years beginning after December 31, 2018.

[20] Sec. 701.

[21] Sec. 702(a).

[22] 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.

[23] Sec. 705.

[24] 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).

[25] Sec. 704(b)(2).

[26] Treas. Reg. sec. 1.704–1(b)(2).

[27] 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.

[28] 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 be treated as a corporation for Federal income tax purposes. Treas. Reg. sec. 301.7701–3. These are known as the ''check-the-box'' regulations.

[29] Sec. 7704(a).

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).[30]

An exception from corporate treatment is provided for certain publicly traded partnerships, 90 percent or more of whose gross income is qualifying income.[31]

S corporations

For Federal income tax purposes, an S corporation[32] generally is not subject to tax at the corporate level.[33] 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 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.[34]

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.

Electing S corporation status

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.[35] Only individuals (other than nonresident aliens), certain tax-exempt organizations, and certain trusts and estates are permitted shareholders of an S corporation.

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.[36] 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,[37] for certain excise taxes,[38] and certain information reporting requirements.[39]

HOUSE BILL

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. 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.

[30] Sec. 7704(b).

[31] 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)).

[32] An S corporation is so named because its Federal tax treatment is governed by subchapter S of the Code.

[33] Secs. 1363 and 1366.

[34] 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).

[35] Sec. 1361. For this purpose, a husband and wife and all members of a family are treated as one shareholder. Sec. 1361(c)(1).

[36] 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).

[37] Treas. Reg. sec. 301.7701–2(c)(2)(iv).

[38] Treas. Reg. sec. 301.7701–2(c)(2)(v).

[39] Treas. Reg. sec. 301.7701–2(c)(2)(vi).

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.

SENATE AMENDMENT

In general

For taxable years beginning after December 31, 2017 and before January 1, 2026, an individual taxpayer generally may deduct 23 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 23 percent of aggregate qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Special rules apply to specified agricultural or horticultural cooperatives. A limitation based on W–2 wages paid is phased in above a threshold amount of taxable income. A disallowance of the deduction with respect to specified service trades or businesses is also phased in above the threshold amount of taxable income.[40]

Qualified business income

Qualified business income is determined for each qualified trade or business of the taxpayer. For any taxable year, qualified business income means the net amount of qualified items of income, gain, deduction, and loss with respect to the qualified trade or business of the taxpayer. The determination of qualified items of income, gain, deduction, and loss takes into account these items only to the extent included or allowed in the determination of taxable income for the year. For example, if in a taxable year, a qualified business has $100,000 of ordinary income from inventory sales, and makes an expenditure of $25,000 that is required to be capitalized and amortized over 5 years under applicable tax rules, the qualified business income is $100,000 minus $5,000 (current-year ordinary amortization deduction), or $95,000. The qualified 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.

If the net amount of qualified business income from all qualified trades or businesses during the taxable year is a loss, it is carried forward as a loss from a qualified trade or business in the next taxable year. Similar to a qualified trade or business that has a qualified business loss for the current taxable year, any deduction allowed in a subsequent year is reduced (but not below zero) by 23 percent of any carryover qualified business loss. For example, Taxpayer has qualified business income of $20,000 from qualified business A and a qualified business loss of $50,000 from qualified business B in Year 1. Taxpayer is not permitted a deduction for Year 1 and has a carryover qualified business loss of $30,000 to Year 2. In Year 2, Taxpayer has qualified business income of $20,000 from qualified business A and qualified business income of $50,000 from qualified business B. To determine the deduction for Year 2, Taxpayer reduces the 23 percent deductible amount determined for the qualified business income of $70,000 from qualified businesses A and B by 23 percent of the $30,000 carryover qualified business loss.

Domestic business

Items are treated as qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business within the United States.[41] In the case of a taxpayer who is an individual with otherwise qualified business income from sources within the commonwealth of Puerto Rico, if all the income is taxable under section 1 (income tax rates for individuals) for the taxable year, the "United States" is considered to include Puerto Rico for purposes of determining the individual's qualified business income.

Treatment of investment income

Qualified items do not include specified investment-related income, deductions, or loss. Specifically, qualified items of income, gain, deduction and loss do 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 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. Qualified items under this provision do not include any item of deduction or loss properly allocable to such income.

Reasonable compensation and guaranteed payments

Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business,[42] and to the extent provided in regulations, does not include any amount paid or incurred by a partnership to a partner who is acting other than in his or her capacity as a partner for services.[43]

Qualified trade or business

A qualified trade or business means any trade or business other than a specified service trade or business and other than the trade or business of being an employee.

Specified service business

A specified service trade or business means any trade or business involving the performance of services in the fields of health,[44] law, engineering, architecture, accounting, actuarial science, performing arts,[45] consulting,[46] athletics, financial services, brokerage services, including investing and investment management, trading, or dealing in securities, partnership interests, or commodities, and 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. 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).

Phase-in of specified service business limitation

The exclusion from the definition of a qualified business for specified service trades or businesses phases in for a taxpayer with taxable income in excess of a threshold amount. The threshold amount is $250,000 (200 percent of that amount, or $500,000, in the case of a joint return) (the "threshold amount"). The threshold amount is indexed for inflation. The exclusion from the definition of a qualified business for specified service trades or businesses is fully phased in for a taxpayer with taxable income in excess of the threshold amount plus $50,000 ($100,000 in

[40] For purposes of this provision, taxable income is computed without regard to the 23 percent deduction.

[41] For this purpose, section 864(c) is applied substituting "qualified trade or business (within the meaning of section 199A)" for "nonresident alien individual or a foreign corporation" or "a foreign corporation."

[42] Described in sec. 707(c).

[43] Described in sec. 707(a).

[44] A similar list of service trades or business is provided in section 448(d)(2)(A) and Treas. Reg. sec. 1.448–1T(e)(4)(i). For purposes of section 448, Treasury regulations provide that the performance of services in the field of health means the provision of medical services by physicians, nurses, dentists, and other similar healthcare professionals. The performance of services in the field of health does not include the provision of services not directly related to a medical field, even though the services may purportedly relate to the health of the service recipient. For example, the performance of services in the field of health does not include the operation of health clubs or health spas that provide physical exercise or conditioning to their customers. See Treas. Reg. sec. 1.448–1T(e)(4)(ii).

[45] For purposes of the similar list of services in section 448, Treasury regulations provide that the performance of services in the field of the performing arts means the provision of services by actors, actresses, singers, musicians, entertainers, and similar artists in their capacity as such. The performance of services in the field of the performing arts does not include the provision of services by persons who themselves are not performing artists (*e.g.*, persons who may manage or promote such artists, and other persons in a trade or business that relates to the performing arts). Similarly, the performance of services in the field of the performing arts does not include the provision of services by persons who broadcast or otherwise disseminate the performance of such artists to members of the public (*e.g.*, employees of a radio station that broadcasts the performances of musicians and singers). See Treas. Reg. sec. 1.448–1T(e)(4)(iii).

[46] For purposes of the similar list of services in section 448, Treasury regulations provide that the performance of services in the field of consulting means the provision of advice and counsel. The performance of services in the field of consulting does not include the performance of services other than advice and counsel, such as sales or brokerage services, or economically similar services. For purposes of the preceding sentence, the determination of whether a person's services are sales or brokerage services, or economically similar services, shall be based on all the facts and circumstances of that person's business. Such facts and circumstances include, for example, the manner in which the taxpayer is compensated for the services provided (*e.g.*, whether the compensation for the services is contingent upon the consummation of the transaction that the services were intended to effect). See Treas. Reg. sec. 1.448–1T(e)(4)(iv).

the case of a joint return). For a taxpayer with taxable income within the phase-in range, the exclusion applies as follows.

In computing the qualified business income with respect to a specified service trade or business, the taxpayer takes into account only the applicable percentage of qualified items of income, gain, deduction, or loss, and of allocable W–2 wages. The applicable percentage with respect to any taxable year is 100 percent reduced by the percentage equal to the ratio of the excess of the taxable income of the taxpayer over the threshold amount bears to $50,000 ($100,000 in the case of a joint return).

For example, Taxpayer has taxable income of $280,000, of which $200,000 is attributable to an accounting sole proprietorship after paying wages of $100,000 to employees. Taxpayer has an applicable percentage of 40 percent.[47] In determining includible qualified business income, Taxpayer takes into account 40 percent of $200,000, or $80,000. In determining the includible W–2 wages, Taxpayer takes into account 40 percent of $100,000, or $40,000. Taxpayer calculates the deduction by taking the lesser of 23 percent of $80,000 ($18,400) or 50 percent of $40,000 ($20,000). Taxpayer takes a deduction for $18,400.

Tentative deductible amount for a qualified trade or business

In general

For each qualified trade or business, the taxpayer is allowed a deductible amount equal to the lesser of 23 percent of the qualified business income with respect to such trade or business or 50 percent of the W–2 wages with respect to such business (the ''wage limit''). However, if the taxpayer's taxable income is below the threshold amount, the deductible amount for each qualified trade or business is equal to 23 percent of the qualified business income with respect to each respective trade or business.

W–2 wages

W–2 wages are the total wages[48] subject to wage withholding, elective deferrals,[49] and deferred compensation[50] paid by the qualified trade or business with respect to employment of its employees during the calendar year ending during the taxable year of the taxpayer.[51] W–2 wages do not include any amount which is not properly allocable to the qualified business income as a qualified item of deduction. In addition, W–2 wages do not include any amount which was not properly included in a return filed with the Social Security Administration on or before the 60th day after the due date (including extensions) for such return.

In the case of a taxpayer who is an individual with otherwise qualified business income from sources within the commonwealth of Puerto Rico, if all the income is taxable under section 1 (income tax rates for individuals) for the taxable year, the determination of W–2 wages with respect to the taxpayer's trade or business conducted in Puerto Rico is made without regard to any exclusion under the wage withholding rules[52] for remuneration paid for services in Puerto Rico.

Phase-in of wage limit

The application of the wage limit phases in for a taxpayer with taxable income in excess of the threshold amount. The wage limit applies fully for a taxpayer with taxable income in excess of the threshold amount plus $50,000 ($100,000 in the case of a joint return). For a taxpayer with taxable income within the phase-in range, the wage limit applies as follows.

With respect to any qualified trade or business, the taxpayer compares (1) 23 percent of the taxpayer's qualified business income with respect to the qualified trade or business with (2) 50 percent of the W–2 wages with respect to the qualified trade or business. If the amount determined under (2) is less than the amount determined (1), (that is, if the wage limit is binding), the taxpayer's deductible amount is the amount determined under (1) reduced by the same proportion of the difference between the two amounts as the excess of the taxable income of the taxpayer over the threshold amount bears to $50,000 ($100,000 in the case of a joint return).

For example, H and W file a joint return on which they report taxable income of $520,000. W has a qualified trade or business that is not a specified service business, such that 23 percent of the qualified business income with respect to the business is $15,000. W's share of wages paid by the business is $20,000, such that 50 percent of the W–2 wages with respect to the business is $10,000. The $15,000 amount is reduced by 20 percent[53] of the difference between $15,000 and $10,000, or $1,000. H and W take a deduction for $14,000.

Qualified REIT dividends, cooperative dividends, and publicly traded partnership income

A deduction is allowed under the provision for 23 percent of the taxpayer's aggregate amount of qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income for the taxable year. Qualified REIT dividends do not include any portion of a dividend received from a REIT that is a capital gain dividend[54] or a qualified dividend.[55] A qualified cooperative dividend means a patronage dividend,[56] per-unit retain allocation,[57] qualified written notice of allocation,[58] or any similar amount, provided it is includible in gross income and is received from either (1) a tax-exempt benevolent life insurance association, mutual ditch or irrigation company, cooperative telephone company, like cooperative organization,[59] or a taxable or tax-exempt cooperative that is described in section 1381(a), or (2) a taxable cooperative governed by tax rules applicable to cooperatives before the enactment of subchapter T of the Code in 1962. Qualified publicly traded partnership income means (with respect to any qualified trade or business of the taxpayer), the sum of the (a) the net amount of the taxpayer's allocable share of each qualified item of income, gain, deduction, and loss (that are effectively connected with a U.S. trade or business and are included or allowed in determining taxable income for the taxable year and do not constitute excepted enumerated investment-type income, and not including the taxpayer's reasonable compensation, guaranteed payments for services, or (to the extent provided in regulations) section 707(a) payments for services) from a publicly traded partnership not treated as a corporation, and (b) gain recognized by the taxpayer on disposition of its interest in the partnership that is treated as ordinary income (for example, by reason of section 751).

Determination of the taxpayer's deduction

The taxpayer's deduction for qualified business income is equal to the lesser of the combined qualified business income amount for the taxable year or an amount equal to 23 percent of the taxpayer's taxable income (reduced by any net capital gain[60]) for the taxable year. The combined qualified business income amount is the sum of the deductible amounts determined for each qualified trade or business for the taxable year and 23 percent of the qualified REIT dividends and qualified cooperative dividends received by the taxpayer for the taxable year.

Specified agricultural or horticultural cooperatives

For taxable years beginning after December 31, 2018 but not after December 31, 2025, a deduction is allowed to any specified agricultural or horticultural cooperative equal to the lesser of 23 percent of the cooperative's taxable income for the taxable year or 50 percent of the W–2 wages paid by the cooperative with respect to its trade or business. A specified agricultural or horticultural cooperative is a organization to which subchapter T applies that is engaged in (a) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, (b) the marketing of agricultural or horticultural products that its patrons have so manufactured, produced, grown, or extracted, or (c) the provision of supplies, equipment, or services to farmers or organizations described in the foregoing.

Special rules and definitions

For purposes of the provision, taxable income is determined without regard to the deduction allowable under the provision.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner takes into account the partner's allocable share of each qualified item of income, gain, deduction, and loss, and is treated as having W–2 wages for the taxable year equal to the partner's allocable share of W–2 wages of the partnership. The partner's allocable share of W–2 wages is required to be determined in the same manner as the partner's share of wage expenses. For example, if a partner is allocated a deductible amount of 10 percent of wages paid by the partnership to employees for the taxable year, the partner is required to be allocated 10 percent of the W–2 wages of the partnership for purposes of calculating the wage limit under this deduction. Similarly, each shareholder of an S corporation takes into account the shareholder's pro rata share of each qualified item of income, gain, deduction, and loss, and is treated as having W–2 wages for the taxable year equal to the shareholder's pro rata share of W–2 wages of the S corporation.

Qualified business income is determined without regard to any adjustments prescribed under the rules of the alternative minimum tax.

The provision does not apply to a trust or estate.

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[47] 1 $280,000 − $250,000)/$50,000 = 1 − 30,000/50,000 = 1 − .6 = 40 percent.

[48] Defined in sec. 3401(a).

[49] Within the meaning of sec. 402(g)(3).

[50] Deferred compensation includes compensation deferred under section 457, as well as the amount of any designated Roth contributions (as defined in section 402A).

[51] In the case of a taxpayer with a short taxable year that does not contain a calendar year ending during such short taxable year, the Committee intends that the following amounts shall be treated as the W–2 wages of the taxpayer for the short taxable year: (1) only those wages paid during the short taxable year to employees of the qualified trade or business, (2) only those elective deferrals (within the meaning of section 402(g)(3)) made during the short taxable year by employees of the qualified trade or business, and (3) only compensation actually deferred under section 457 during the short taxable year with respect to employees of the qualified trade or business. The Committee intends that amounts that are treated as W–2 wages for a taxable year shall not be treated as W–2 wages of any other taxable year.

[52] As provided in sec. 3401(a)(8).

[53] ($520,000 − $500,000)/$100,000 = 20 percent.

[54] Defined in sec. 857(b)(3).

[55] Defined in sec. 1(h)(11).

[56] Defined in sec. 1388(a).

[57] Defined in sec. 1388(f).

[58] Defined in sec. 1388(c).

[59] Described in sec. 501(c)(12).

[60] Defined in sec. 1(h).

The deduction under the provision is allowed only for Federal income tax purposes.

For purposes of determining a substantial underpayment of income tax under the accuracy related penalty,[61] a substantial underpayment exists if the amount of the understatement exceeds the greater of five percent (not 10 percent) of the tax required to be shown on the return or $5,000.

Authority is provided to promulgate regulations needed to carry out the purposes of the provision, including regulations requiring, or restricting, the allocation of items of income, gain, loss, or deduction, or of wages under the provision. In addition, regulatory authority is provided to address reporting requirements appropriate under the provision, and the application of the provision in the case of tiered entities.

The provision does not apply to taxable years beginning after December 31, 2025.

Additional examples

The following examples provide a comprehensive illustration of the provision.

Example 1

H and W file a joint return on which they report taxable income of $520,000 (determined without regard to this provision). H is a partner in a qualified trade or business that is not a specified service business (''qualified business A''). W has a sole proprietorship qualified trade or business that is a specified service business (''qualified business B''). H and W also received $10,000 in qualified REIT dividends during the tax year.

H's allocable share of qualified business income from qualified business A is $300,000, such that 23 percent of the qualified business income with respect to the business is $69,000.[62] H's allocable share of wages paid by qualified business A is $100,000, such that 50 percent of the W–2 wages with respect to the business is $50,000.[63] As H and W's taxable income is above the threshold amount for a joint return, the application of the wage limit for qualified business A is phased in. Accordingly, the $69,000 amount is reduced by 20 percent[64] of the difference between $69,000 and $50,000, or $3,800.[65] H's deductible amount for qualified business A is $65,200.[66]

W's qualified business income and W–2 wages from qualified business B, which is a specified service business, are $325,000 and $150,000, respectively. H and W's taxable income is above the threshold amount for a joint return. Thus, the exclusion of qualified business income and W–2 wages from the specified service business are phased in. W has an applicable percentage of 80 percent.[67] In determining includible qualified business income, W takes into account 80 percent of $325,000, or $260,000. In determining includible W–2 wages, W takes into account 80 percent of $150,000, or $120,000. W calculates the deductible amount for qualified business B by taking the lesser of 23 percent of $260,000 ($59,800) or 50 percent of includible W–2 wages of $120,000 ($60,000).[68] W's deductible amount for qualified business B is $59,800.

H and W's combined qualified business income amount of $127,300 is comprised of the deductible amount for qualified business A of $65,200, the deductible amount for qualified business B of $59,800, and 23 percent of the $10,000 qualified REIT dividends ($2,300). H and W's deduction is limited to 23 percent of their taxable income for the year ($520,000), or $119,600. Accordingly, H and W's deduction for the taxable year is $119,600.

Example 2

H and W file a joint return on which they report taxable income of $200,000 (determined without regard to this provision). H has a sole proprietorship qualified trade or business that is not a specified service business (''qualified business A''). W is a partner in a qualified trade or business that is not a specified service business (''qualified business B''). H and W have a carryover qualified business loss of $50,000.

H's qualified business income from qualified business A is $150,000, such that 23 percent of the qualified business income with respect to the business is $34,500. As H and W's taxable income is below the threshold amount for a joint return, the wage limit does not apply to qualified business A. H's deductible amount for qualified business A is $34,500.

W's allocable share of qualified business loss is $40,000, such that 23 percent of the qualified business loss with respect to the business is $9,200. As H and W's taxable income is below the threshold amount for a joint return, the wage limit does not apply to qualified business B. W's deductible amount for qualified business B is a reduction to the deduction of $9,200.

H and W's combined qualified business income amount of $13,800 is comprised of the deductible amount for qualified business A of $34,500, the reduction to the deduction for qualified business B of $9,200, and the reduction to the deduction of $11,500 attributable to the carryover qualified business loss. H and W's deduction is limited to 23 percent of their taxable income for the year ($200,000), or $46,000. Accordingly, H and W's deduction for the taxable year is $13,800.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with modifications.

Deduction percentage

Under the conference agreement, the percentage of the deduction allowable under the provision is 20 percent (not 23 percent).

Threshold amount

The conference agreement reduces the threshold amount above which both the limitation on specified service businesses and the wage limit are phased in. Under the conference agreement, the threshold amount is $157,500 (twice that amount or $315,000 in the case of a joint return), indexed. The conferees expect that the reduced threshold amount will serve to deter high-income taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20-percent deduction under the provision.

The conference agreement provides that the range over which the phase-in of these limitations applies is $50,000 ($100,000 in the case of a joint return).

Limitation based on W–2 wages and capital

The conference agreement modifies the wage limit applicable to taxpayers with taxable income above the threshold amount to provide a limit based either on wages paid or on wages paid plus a capital element. Under the conference agreement, the limitation is the greater of (a) 50 percent of the W–2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 of percent of the W–2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.

For purposes of the provision, qualified property means tangible property of a character subject to depreciation that is held by, and available for use in, the qualified trade or business at the close of the taxable year, and which is used in the production of qualified business income, and for which the depreciable period has not ended before the close of the taxable year. The depreciable period with respect to qualified property of a taxpayer means the period beginning on the date the property is first placed in service by the taxpayer and ending on the later of (a) the date 10 years after that date, or (b) the last day of the last full year in the applicable recovery period that would apply to the property under section 168 (without regard to section 168(g)).

For example, a taxpayer (who is subject to the limit) does business as a sole proprietorship conducting a widget-making business. The business buys a widget-making machine for $100,000 and places it in service in 2020. The business has no employees in 2020. The limitation in 2020 is the greater of (a) 50 percent of W–2 wages, or $0, or (b) the sum of 25 percent of W–2 wages ($0) plus 2.5 percent of the unadjusted basis of the machine immediately after its acquisition: $100,000 × .025 = $2,500. The amount of the limitation on the taxpayer's deduction is $2,500.

In the case of property that is sold, for example, the property is no longer available for use in the trade or business and is not taken into account in determining the limitation. The Secretary is required to provide rules for applying the limitation in cases of a short taxable year of where the taxpayer acquires, or disposes of, the major portion of a trade or business or the major portion of a separate unit of a trade or business during the year. The Secretary is required to provide guidance applying rules similar to the rules of section 179(d)(2) to address acquisitions of property from a related party, as well as in a sale-leaseback or other transaction as needed to carry out the purposes of the provision and to provide anti-abuse rules, including under the limitation based on W–2 wages and capital. Similarly, the Secretary shall provide guidance prescribing rules for determining the unadjusted basis immediately after acquisition of qualified property acquired in like-kind exchanges or involuntary conversions as needed to carry out the purposes of the provision and to provide anti-abuse rules, including under the limitation based on W–2 wages and capital.

Specified service trade or business

The conference agreement modifies the definition of a specified service trade or business in several respects. The definition is modified to exclude engineering and architecture services, and to take into account the reputation or skill of owners.

A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or 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 owners, or which involves the performance of services that consist of investing and investment management 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).

Determination of the taxpayer's deduction

The taxpayer's deduction for qualified business income for the taxable year is equal

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[61] Sec. 6662(d)(1)(A).

[62] $300,000*.23 = $69,000.

[63] $100,000*.5 = $50,000.

[64] ($520,000 − $500,000)/$100,000 = 20 percent.

[65] ($69,000 − $50,000)*.2 = $3,800.

[66] $69,000 − $3,800 = $65,200.

[67] 1 − ($520,000 − $500,000)/$100,000 = 1 − $20,000/$100,000 = 1 − .2 = 80 percent.

[68] Although H and W's taxable income is above the threshold amount for a joint return, the wage limit is not binding as the 23 percent of includible qualified business income of qualified business B ($59,800) is less than 50 percent of includible W–2 wages of qualified business B ($60,000).

to the sum of (a) the lesser of the combined qualified business income amount for the taxable year or an amount equal to 20 percent of the excess of taxpayer's taxable income over any net capital gain[69] and qualified cooperative dividends, plus (b) the lesser of 20 percent of qualified cooperative dividends and taxable income (reduced by net capital gain). This sum may not exceed the taxpayer's taxable income for the taxable year (reduced by net capital gain). Under the provision, the 20-percent deduction with respect to qualified cooperative dividends is limited to taxable income (reduced by net capital gain) for the year. The combined qualified business income amount for the taxable year is the sum of the deductible amounts determined for each qualified trade or business carried on by the taxpayer and 20 percent of the taxpayer's qualified REIT dividends and qualified publicly traded partnership income. The deductible amount for each qualified trade or business is the lesser of (a) 20 percent of the taxpayer's qualified business income with respect to the trade or business, or (b) the greater of 50 percent of the W–2 wages with respect to the trade or business or the sum of 25 percent of the W–2 wages with respect to the trade or business and 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property.

Deduction against taxable income

The conference agreement clarifies that the 20-percent deduction is not allowed in computing adjusted gross income, and instead is allowed as a deduction reducing taxable income. Thus, for example, the provision does not affect limitations based on adjusted gross income. Similarly the conference agreement clarifies that the deduction is available to both non-itemizers and itemizers.

Treatment of agricultural and horticultural cooperatives

For taxable years beginning after December 31, 2017 but not after December 31, 2025, a deduction is allowed to any specified agricultural or horticultural cooperative equal to the lesser of (a) 20 percent of the cooperative's taxable income for the taxable year or (b) the greater of 50 percent of the W–2 wages paid by the cooperative with respect to its trade or business or the sum of 25 percent of the W–2 wages of the cooperative with respect to its trade or business plus 2.5 percent of the unadjusted basis immediately after acquisition of qualified property of the cooperative. A specified agricultural or horticultural cooperative is a organization to which subchapter T applies that is engaged in (a) the manufacturing, production, growth, or extraction in whole or significant part of any agricultural or horticultural product, (b) the marketing of agricultural or horticultural products that its patrons have so manufactured, produced, grown, or extracted, or (c) the provision of supplies, equipment, or services to farmers or organizations described in the foregoing.

Treatment of trusts and estates

The conference agreement provides that trusts and estates are eligible for the 20-percent deduction under the provision. Rules similar to the rules under present-law section 199 (as in effect on December 1, 2017) apply for apportioning between fiduciaries and beneficiaries any W–2 wages and unadjusted basis of qualified property under the limitation based on W–2 wages and capital.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

[69] Defined in sec. 1(h).

C. Simplification and Reform of Family and Individual Tax Credits

1. Enhancement of child tax credit and new family credit (sec. 1101 of the House bill, sec. 11022 of the Senate amendment, 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[70] (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-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 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.

HOUSE BILL

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.

[70] The refundable credit may not exceed the maximum credit per child of $1,000.

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.[71] 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.[72]

The $300 credit for the taxpayer, spouse, and non-child dependents of the taxpayer expires for taxable years beginning after December 31, 2022.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The provision temporarily increases the child tax credit to $2,000 per qualifying child. Additionally, the age limit for a qualifying child is temporarily increased by one year, such that a taxpayer may claim the credit with respect to any qualifying child under the age of 18. This increase in the age limit expires for taxable years after December 31, 2024.

The credit is further modified to temporarily provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children. The provision generally retains the present-law definition of dependent.

Under the temporary provision, beginning in 2018, the threshold at which the credit begins to phase out is increased to $500,000 for all taxpayers. These amounts are not indexed for inflation.

The provision temporarily lowers the earned income threshold for the refundable child tax credit to $2,500. As under present law, the maximum amount refundable may not exceed $1,000 per qualifying child. Under the provision, this $1,000 threshold is indexed for inflation with a base year of 2017, rounding up to the nearest $100 (such that the threshold is $1,100 in 2018). A temporary rule provides that, for the taxable years for which the above-described changes are in effect, in order to receive the refundable portion of the child tax credit, a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return.

The temporary provision (other than the increase in the age limit, which expires one year earlier) expires for taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

[71] The alternate formula described in the present law section applies to the refundable portion of the family credit as well.

[72] See a description of sec. 1103 of the House bill for modifications to the taxpayer identification number requirement.

CONFERENCE AGREEMENT

The conference agreement temporarily increases the child tax credit to $2,000 per qualifying child. The credit is further modified to temporarily provide for a $500 nonrefundable credit for qualifying dependents other than qualifying children. The provision generally retains the present-law definition of dependent.

Under the conference agreement, the maximum amount refundable may not exceed $1,400 per qualifying child.[73] Additionally, the conference agreement provides that, in order to receive the child tax credit (i.e., both the refundable and non-refundable portion), a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return. For these purposes, a Social Security number must be issued before the due date for the filing of the return for the taxable year. This requirement does not apply to a non-child dependent for whom the $500 nonrefundable credit is claimed.[74]

Further, the conference agreement retains the present-law age limit for a qualifying child. Thus, a qualifying child is an individual who has not attained age 17 during the taxable year.

Finally, the conference agreement modifies the adjusted gross income phaseout thresholds. Under the conference agreement, the credit begins to phase out for taxpayers with adjusted gross income in excess of $400,000 (in the case of married taxpayers filing a joint return) and $200,000 (for all other taxpayers). These phaseout thresholds are not indexed for inflation.

As was the case with the Senate amendment, the provision expires for taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

2. Credit for the elderly and permanently disabled (sec. 1102(a) of the House 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.[75] 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.[76] 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.[77]

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.[78] 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.[79]

HOUSE BILL

The House bill repeals the credit for the elderly and permanently disabled.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

3. Repeal of credit for plug-in electric drive motor vehicles (sec. 1102(c) of the House 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.[80] 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). Qualified vehicles are subject to a 200,000 vehicle-per-manufacturer limitation. Once the limitation has been reached the credit is phased down over four calendar quarters.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

4. Termination of credit for interest on certain home mortgages (sec. 1102(b) of the House 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'').[81] 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.[82]

HOUSE BILL

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.

SENATE AMENDMENT

No Provision.

CONFERENCE AGREEMENT

The conference agreement does not contain the House bill provision.

5. Modification of taxpayer identification number requirements for the child tax credit, earned income credit, and American Opportunity credit (sec. 1103 of the House bill, sec. 11022 of the Senate amendment 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[83] 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) 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[84]

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

[73] Unlike both the House bill and the Senate amendment, the conference agreement uses an indexing convention that rounds the $1,400 amount to the next lowest multiple of $100.

[74] Additionally, a qualifying child who is ineligible to receive the child tax credit because that child did not have a Social Security number as the child's taxpayer identification number may nonetheless qualify for the non-refundable $500 credit.

[75] Sec. 22(a).

[76] Sec. 22(d).

[77] Sec. 22(c)(3).

[78] Sec. 22(b).

[79] Sec. 22(e)(3).

[80] Sec. 30D.

[81] Sec. 25.

[82] Sec. 143.

[83] 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.

[84] See description of sec. 1101 of the House bill for the House bill and Senate amendment modifications to the child tax credit.

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[85] 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[86]

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 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'').[87] 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.[88] An individual who is eligible to receive an SSN may not obtain an ITIN for purposes of his or her tax filing obligations.[89] 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,[90] an individual who is a U.S. resident alien under the substantial presence test and who therefore must file a U.S. tax return,[91] 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.[92] 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. 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.

HOUSE BILL

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.[93]

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 is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

Under the Senate amendment, as a part of the temporary modifications to the child tax credit, for the taxable years 2018 through 2025, in order to receive the refundable portion of the child tax credit, a taxpayer must include a Social Security number for each qualifying child for whom the credit is claimed on the tax return.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not contain the House bill provision.[94]

6. Procedures to reduce improper claims of earned income credit (sec. 1104 of the House 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.

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.[95] Special rules apply in computing earned income for purposes of the EIC.[96] 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.[97]

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'').[98] 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

[85] Sec. 911.

[86] See description of sec. 1201 of the House bill for the bill's modifications to the American Opportunity credit.

[87] Sec. 6109(a).

[88] Treas. Reg. Sec. 301.6109–1(d)(3)(i).

[89] Treas. Reg. Sec. 301.6109–1(d)(3)(ii).

[90] 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.

[91] Such an individual would have a filing requirement without regard to whether the individual is lawfully present or has work authorization.

[92] 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.

[93] See description of sec. 1101 of the House bill.

[94] But see description of sec. 11022 of the conference agreement for a description of modifications with respect to the taxpayer identification number requirements pertaining to the child tax credit.

[95] Sec. 32(c)(2)(A).

[96] Sec. 32(c)(2)(B).

[97] Sec. 1402(a); Chief Counsel Advice 200022051.

[98] 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.

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.[99] 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.[100] 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.

HOUSE BILL

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.

Effective date.—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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

7. Certain income disallowed for purposes of the earned income tax credit (sec. 1105 of the House 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.[101] Special rules apply in computing earned income for purposes of the EIC.[102]

Information reporting

Present law imposes a variety of information reporting requirements on participants in certain transactions.[103] 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.[104] 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.[105] 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.[106]

Special information reporting requirements exist for employers required to deduct and withhold tax from employees' income.[107] 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.[108]

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.[109]

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.[110] The statement must be supplied to taxpayers by the payors by January 31 of the following calendar year.[7] Payors generally must file the information return with the IRS on or before January 31 of the year following the calendar year to which such returns relate.[111]

Failure to comply with the information reporting requirements results in penalties, which may include a penalty for failure to file the information return,[112] to furnish payee statements,[113] or to comply with other various reporting requirements.[114] No penalty is imposed if the failure is due to reasonable cause.[115] 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.[116] 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.[117] 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.[118]

HOUSE BILL

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.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

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[99] 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.

[100] Sec. 6051(a). Employees are required to include a copy of Form W–2 when filing their income tax returns.

[101] Sec. 32(c)(2)(A).

[102] Sec. 32(c)(2)(B).

[103] Sec. 6031 through 6060.

[104] 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).

[105] 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.

[106] Secs. 6042 (dividends), 6045 (broker reporting) and 6049 (interest) and the Treasury regulations thereunder.

[107] Sec. 6051(a).

[108] Sec. 6041A.

[109] Sec. 6050W.

[110] Sec. 6041(d).

[111] Sec. 6071(d).

[112] Sec. 6721.

[113] Sec. 6722.

[114] Sec. 6723.

[115] Sec. 6724.

[116] Sec. 6001.

[117] Treas. sec. 1.6001–1(a).

[118] Treas. sec. 1.6001–1(e).

8. Limitation on losses for taxpayers other than corporations (sec. 11012 of the Senate amendment and sec. 461(l) of the Code)

PRESENT LAW

Loss limitation rules applicable to individuals

Passive loss rules

The passive loss rules limit deductions and credits from passive trade or business activities.[119] The passive loss rules apply to individuals, estates and trusts, and closely held corporations. A passive activity for this purpose is a trade or business activity in which the taxpayer owns an interest, but in which the taxpayer does not materially participate. A taxpayer is treated as materially participating in an activity only if the taxpayer is involved in the operation of the activity on a basis that is regular, continuous, and substantial.[120] Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer makes a taxable disposition of his entire interest in the passive activity to an unrelated person.

Excess farm loss rules

A limitation on excess farm losses applies to taxpayers other than C corporations.[121] If a taxpayer other than a C corporation receives an applicable subsidy for the taxable year, the amount of the excess farm loss is not allowed for the taxable year, and is carried forward and treated as a deduction attributable to farming businesses in the next taxable year. An excess farm loss for a taxable year means the excess of aggregate deductions that are attributable to farming businesses over the sum of aggregate gross income or gain attributable to farming businesses plus the threshold amount. The threshold amount is the greater of (1) $300,000 ($150,000 for married individuals filing separately), or (2) for the five-consecutive-year period preceding the taxable year, the excess of the aggregate gross income or gain attributable to the taxpayer's farming businesses over the aggregate deductions attributable to the taxpayer's farming businesses.

HOUSE BILL

No provision.

SENATE AMENDMENT

For taxable years beginning after December 31, 2017 and before January 1, 2026, excess business losses of a taxpayer other than a corporation are not allowed for the taxable year. Such losses are carried forward and treated as part of the taxpayer's net operating loss (''NOL'') carryforward in subsequent taxable years. Under the bill, NOL carryovers generally are allowed for a taxable year up to the lesser of the carryover amount or 90 percent (80 percent for taxable years beginning after December 31, 2022) of taxable income determined without regard to the deduction for NOLs.

An excess business loss for the taxable year is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer (determined without regard to the limitation of the provision), over the sum of aggregate gross income or gain of the taxpayer plus a threshold amount. The threshold amount for a taxable year is $250,000 (or twice the otherwise applicable threshold amount in the case of a joint return). The threshold amount is indexed for inflation.

In the case of a partnership or S corporation, the provision applies at the partner or shareholder level. Each partner's distributive share and each S corporation shareholder's pro rata share of items of income, gain, deduction, or loss of the partnership or S corporation are taken into account in applying the limitation under the provision for the taxable year of the partner or S corporation shareholder. Regulatory authority is provided to apply the provision to any other passthrough entity to the extent necessary to carry out the provision. Regulatory authority is also provided to require any additional reporting as the Secretary determines is appropriate to carry out the purposes of the provision.

The provision applies after the application of the passive loss rules.[122]

For taxable years beginning after December 31, 2017 and before January 1, 2026, the present-law limitation relating to excess farm losses does not apply.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment. Thus, excess business losses not allowed are carried forward and treated as part of the taxpayer's net operating loss (''NOL'') carryforward in subsequent taxable years as determined under the NOL rules provided under the conference agreement.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

9. Reform of American opportunity tax credit and repeal of lifetime learning credit (sec. 1201 of the House 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.[123]

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.[124] 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 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.

HOUSE BILL

The House bill modifies the American Opportunity credit[125] 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 provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

[119] Sec. 469.

[120] Regulations provide more detailed standards for material participation. See Treas. Reg. sec. 1.469–5 and –5T.

[121] Sec. 461(j).

[122] Sec. 469.

[123] Sec. 25A(b)(2)(D).

[124] Sec. 25A(a)(2).

[125] 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.

10. Consolidation and modification of education savings rules (sec. 1202 of the House bill, sec. 11033 of the Senate amendment, 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.[126] 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.[127] 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.[128]

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 secondary 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.[129] 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.[130]

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.[131] In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (a "savings account program"). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary's higher education expenses.

In general, prepaid tuition contracts and tuition savings accounts established under a qualified tuition program involve prepayments or contributions made by one or more individuals for the benefit of a designated beneficiary. 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")[132] 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).

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.

HOUSE BILL

Under the House bill, 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

[126] Sec. 530.

[127] In addition, Coverdell education savings accounts are subject to the unrelated business income tax imposed by section 511.

[128] 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.

[129] Qualified higher education expenses are defined in the same manner as for qualified tuition programs.

[130] Sec. 530(b)(2)(B).

[131] 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.

[132] 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.

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.

SENATE AMENDMENT

The Senate amendment 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 the definition of higher education expenses to include certain expenses incurred in connection with a homeschool. Those expenses are (1) curriculum and curricular materials; (2) books or other instructional materials; (3) online educational materials; (4) tuition for tutoring or educational classes outside of the home (but only if the tutor or instructor is not related to the student); (5) dual enrollment in an institution of higher education; and (6) educational therapies for students with disabilities.

Effective date.—The provision applies to distributions made after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

11. Reforms to discharge of certain student loan indebtedness (sec. 1203 of the House bill, sec. 11031 of the Senate amendment, and sec. 108 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.[133]

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).

HOUSE BILL

The House bill 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).[134]

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.[135]

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.[136]

Effective date.—The provision applies to discharges of loans after, and amounts received after, December 31, 2017.

SENATE AMENDMENT

The Senate amendment generally follows the House bill. However, the Senate amendment does not contain the provision in the House bill excluding amounts received under the Indian Health Service loan repayment program from income.

Additionally, the Senate amendment does not apply to discharges of indebtedness occurring after December 31, 2025.

Effective date.—The provision is effective for discharges of indebtedness after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

12. Repeal of deduction for student loan interest (sec. 1204 of the House 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.[137] 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.[138]

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 incurred 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.

[133] Sec. 108(f).

[134] 15 U.S.C. 1650(7).

[135] 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.

[136] 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.

[137] Sec. 221.

[138] Sec. 221(c).

The maximum allowable deduction per year is $2,500.[139] 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.

HOUSE BILL

The provision repeals the deduction for student loan interest.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

13. Repeal of deduction for qualified tuition and related expenses (sec. 1204 of the House 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.[140] 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.

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).[141] 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.

HOUSE BILL

The provision repeals the deduction for qualified tuition and related expenses.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

14. Repeal of exclusion for qualified tuition reductions (sec. 1204 of the House bill and sec. 117(d) of the Code)

PRESENT LAW

Qualified tuition reductions for certain education provided to employees (and their spouses and dependents[142]) of certain educational organizations are excludible from gross income.[143] The tuition reduction is subject to nondiscrimination rules.[144] 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.

HOUSE BILL

The provision repeals the exclusions from gross income and wages for qualified tuition reductions.

Effective date.—The provision applies to amounts paid or incurred after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

15. Repeal of exclusion for interest on United States savings bonds used for higher education expenses (sec. 1204 of the House 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.[145] 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.

HOUSE BILL

The House bill repeals exclusion for interest on Series EE savings bond used for qualified higher education expenses.

Effective date.—The provision generally applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

16. Repeal of exclusion for educational assistance programs (sec. 1204 of the House 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.[146] Nondiscrimination rules[147] 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 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

17. Rollovers between qualified tuition programs and qualified ABLE programs (sec. 1205 of the House bill, sec. 11025 of the Senate amendment and secs. 529 and 529A of the Code)

PRESENT LAW

Qualified ABLE programs

The Code provides for a tax-favored savings program intended to benefit disabled individuals, known as qualified ABLE programs.[148] 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

[139] Sec. 221(b)(1).

[140] Sec. 222(a).

[141] Sec. 222(b)(2)(B).

[142] Individuals described under the rules of Sec. 132(h).

[143] Educational organization described in section 170(b)(1)(A)(ii). Sec. 117(d)(2).

[144] 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.

[145] Sec. 135.

[146] Sec. 127(a).

[147] 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.

[148] Sec. 529A.

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.[149] 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 beneficiary. 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.[150] 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[151] 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,[152] 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[153] 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 Security 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.[154]

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.

HOUSE BILL

The House bill 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.[155] Such rolled-over amounts count towards the overall limitation on amounts that can be contributed to an ABLE account within a taxable year.[156] 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.[157]

Effective date.—The provision applies to distributions after December 31, 2017.

SENATE AMENDMENT

The Senate amendment generally follows the House Bill. Under the Senate amendment, the provision is not effective for distributions after December 31, 2025.

Effective date.—The provision applies to distributions after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

18. Repeal of overall limitation on itemized deductions (sec. 1301 of the House bill, sec. 11046 of the Senate amendment, 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.[158] 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

[149] 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.

[150] The rules of section 72 apply in determining the portion of a distribution that consists of earnings.

[151] For instance, if a designated beneficiary were to relocate to a different State.

[152] In which case the contributor ABLE account must be closed 60 days after the transfer to the new ABLE account is made.

[153] These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

[154] No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

[155] 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.

[156] 529A(b)(2)(B).

[157] 529(c)(3)(A).

[158] Sec. 68.

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.

HOUSE BILL

The House bill repeals the overall limitation on itemized deductions.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment follows the House bill. Under the Senate amendment, the suspension of the overall limitation on itemized deductions does not apply to taxable years beginning after December 31, 2025.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

D. Simplification and Reform of Deductions and Exclusions

1. Modification of deduction for home mortgage interest (sec. 1302 of the House bill, sec. 11043 of the Senate amendment, and sec. 163(h) of the Code)

PRESENT LAW

As a general matter, personal interest is not deductible.[159] Qualified residence interest is not treated as personal interest and is allowed as an itemized deduction, subject to limitations.[160] 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.

[159] Sec. 163(h)(1).

[160] Sec. 163(h)(2)(D) and (h)(3).

Interest on home equity indebtedness is not deductible in computing alternative minimum taxable income.

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).

HOUSE BILL

The House bill 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).[161] 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.

Effective date.—The provision is effective for interest paid or accrued in taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment suspends the deduction for interest on home equity indebtedness. Thus, for taxable years beginning after December 31, 2017, a taxpayer may not claim a deduction for interest on home equity indebtedness. The suspension ends for taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

[161] 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.

CONFERENCE AGREEMENT

The conference agreement provides that, in the case of taxable years beginning after December 31, 2017, and beginning before January 1, 2026, a taxpayer may treat no more than $750,000 as acquisition indebtedness ($375,000 in the case of married taxpayers filing separately). In the case of acquisition indebtedness incurred before December 15, 2017[162] this limitation is $1,000,000 ($500,000 in the case of married taxpayers filing separately).[163] For taxable years beginning after December 31, 2025, a taxpayer may treat up to $1,000,000 ($500,000 in the case of married taxpayers filing separately) of indebtedness as acquisition indebtedness, regardless of when the indebtedness was incurred.

Additionally, the conference agreement suspends the deduction for interest on home equity indebtedness. Thus, for taxable years beginning after December 31, 2017, a taxpayer may not claim a deduction for interest on home equity indebtedness. The suspension ends for taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

2. Modification of deduction for taxes not paid or accrued in a trade or business (sec. 1303 of the House bill, sec. 11042 of the Senate amendment, and sec. 164 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;[164] (ii) State and local personal property taxes;[165] (iii) State, local, and foreign income, war profits, and excess profits taxes.[166] 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.[167]

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.[168]

Individuals also are permitted a deduction for Federal and State generation skipping transfer tax (''GST tax'') imposed on certain

[162] The conference agreement provides that a taxpayer who has entered into a binding written contract before December 15, 2017 to close on the purchase of a principal residence before January 1, 2018, and who purchases such residence before April 1, 2018, shall be considered to incurred acquisition indebtedness prior to December 15, 2017 under this provision.

[163] Special rules apply in the case of indebtedness from refinancing existing 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 December 15, 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.

[164] Sec. 164(a)(1).

[165] Sec. 164(a)(2).

[166] Sec. 164(a)(3). A foreign tax credit, in lieu of a deduction, is allowable for foreign taxes if the taxpayer so elects.

[167] Sec. 164(b)(5).

[168] See H. Rep. No. 1365 to accompany Individual Income Tax Bill of 1944 (78th Cong., 2d. Sess.), reprinted at 19 C.B. 839 (1944).

income distributions that are included in the gross income of the distributee.[169]

In determining a taxpayer's alternative minimum taxable income, no itemized deduction for property, income, or sales tax is allowed.

HOUSE BILL

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).[170] 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.

SENATE AMENDMENT

The Senate amendment follows the House bill. However, under the Senate amendment, the suspension of the deduction for State and local taxes expires for taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement provides that in the case of an individual,[171] 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).[172] 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).

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.

The provision contains an exception to the above-stated rule. Under the provision a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for the aggregate of (i) State and local property taxes not paid or accrued in carrying on a trade or business, or an activity described in section 212, and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year. Foreign real property taxes may not be deducted under this exception.

The above rules apply to taxable years beginning after December 31, 2017, and beginning before January 1, 2026.

The conference agreement also provides that, in the case of an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, the payment shall be treated as paid on the last day of the taxable year for which such tax is so imposed for purposes of applying the provision limiting the dollar amount of the deduction. Thus, under the provision, an individual may not claim an itemized deduction in 2017 on a prepayment of income tax for a future taxable year in order to avoid the dollar limitation applicable for taxable years beginning after 2017.

Effective date.—The provision is effective for taxable years beginning after December 31, 2016.

3. Repeal of deduction for personal casualty and theft losses (sec. 1304 of the House bill, sec. 11044 of the Senate amendment, 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.[173] 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.

HOUSE BILL

The House bill 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,[174] for those individuals who sustained a personal casualty loss arising from hurricanes Harvey, Irma, or Maria.

Effective date.—The provision is effective for losses incurred in taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment temporarily modifies the deduction for personal casualty and theft losses. Under the provision, a taxpayer may claim a personal casualty loss (subject to the limitations described above) only if such loss was attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

The above-described limitation does not apply with respect to losses incurred after December 31, 2025.

Effective date.—The provision is effective for losses incurred in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

4. Limitation on wagering losses (sec. 1305 of the House bill, sec. 11051 of the Senate amendment, 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.[175]

HOUSE BILL

The House bill 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.[176] 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.

SENATE AMENDMENT

The Senate amendment follows the House bill. However, the Senate amendment does not apply to taxable years beginning after December 31, 2025.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

5. Modifications to the deduction for charitable contributions (sec. 1306 of the House bill, secs. 11023, 13703, and 13704 of the Senate amendment, 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

[169] Sec. 164(a)(4).

[170] The proposal does not modify the deductibility of GST tax imposed on certain income distributions. Additionally, taxes imposed at the entity level, such as a business tax imposed on pass-through entities, that are reflected in a partner's or S corporation shareholder's distributive or pro-rata share of income or loss on a Schedule K–1 (or similar form), will continue to reduce such partner's or shareholder's distributive or pro-rata share of income as under present law.

[171] See sec. 641(b) regarding the computation of taxable income of an estate or trust in the same manner as an individual.

[172] The proposal does not modify the deductibility of GST tax imposed on certain income distributions. Additionally, taxes imposed at the entity level, such as a business tax imposed on pass-through entities, that are reflected in a partner's or S corporation shareholder's distributive or pro-rata share of income or loss on a Schedule K–1 (or similar form), will continue to reduce such partner's or shareholder's distributive or pro-rata share of income as under present law.

[173] Sec. 165(c).

[174] Pub. L. No. 115–63.

[175] Sec. 165(d).

[176] 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).

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.[177] Fourth, the transfer must be of money or property—contributions of services are not deductible.[178] 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.[179] 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.[180] 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 the effect of reserving to, or retaining in, such donor a right to the use, possession, or enjoyment of the property.''[181]

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.[182] 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.[183] 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.[184]

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.[185] 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.

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.[186] 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.[187] Charitable contributions of income interests (where deductible) also generally are treated as contributions for the use of the donee organization.

TABLE 3.—CHARITABLE CONTRIBUTION PERCENTAGE LIMITS FOR INDIVIDUAL TAXPAYERS [188]

	Ordinary Income Property and Cash	Capital Gain Property to the Recipient [189]	Capital Gain Property for the use of the Recipient
Public Charities, Private Operating Foundations, and Private Distributing Foundations	50%	[190] 30%	20%
Nonoperating Private Foundations	30%	20%	20%

[177] Sec. 170(a)(1).

[178] 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.

[179] Secs. 170(f)(3)(A) (income tax), 2055(e)(2) (estate tax), and 2522(c)(2) (gift tax).

[180] Sec. 170(a)(3).

[181] 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).

[182] Sec. 170(f)(3)(B)(ii).

[183] Treas. Reg. sec. 1.170A–7(b)(1).

[184] Treas. Reg. sec. 1.170A–7(b)(1).

[185] Secs. 170(f)(3)(B)(iii) and 170(h).

[186] Sec. 170(b)(1)(G).

[187] *Rockefeller v. Commissioner*, 676 F.2d 35, 39 (2d Cir. 1982).

Corporate taxpayers

A corporation generally may deduct charitable contributions up to 10 percent of the corporation's taxable income for the year.[191] 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.[192]

Carryforwards of excess contributions

Charitable contributions that exceed the applicable percentage limit generally may be carried forward for up to five years.[193] 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.[194] 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 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.[195]

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.[196] 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;[197] (2) contributions of tangible personal property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose;[198] and (3) contributions to or for the use of a private foundation (other than certain private operating foundations).[199]

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.[200] Qualified appreciated stock is stock that is capital gain property and for which (as of the date of the contribution) market quotations are readily available on an established securities market.[201] 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.[202]

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.[203] 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.[204] 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.[205]

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 enacted 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)[206] 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.[207] In

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[188] Percentages shown are the percentage of an individual's contribution base.

[189] 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.

[190] 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.

[191] Sec. 170(b)(2)(A).

[192] Sec. 170(b)(2)(C).

[193] Sec. 170(d).

[194] Sec. 170(b)(1)(E).

[195] Sec. 170(b)(2)(B).

[196] 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).

[197] Sec. 170(e). Special rules, discussed below, apply for certain contributions of inventory and other property.

[198] Sec. 170(e)(1)(B)(i)(I).

[199] 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.

[200] Sec. 170(e)(5).

[201] Sec. 170(e)(5)(B).

[202] Sec. 170(e)(5)(C).

[203] Sec. 170(e)(3).

[204] Sec. 170(e)(3)(A)(i)–(iii).

[205] Sec. 170(e)(3)(C).

[206] 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).

[207] Sec. 170(e)(1)(B)(iii).

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).[208]

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 may be deducted if the taxpayer includes with the taxpayer's return a qualified appraisal with respect to the property.[209] 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.[210]

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.[211]

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.[212] 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.[213]

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.[214] 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 expenses 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.[215]

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.[216] 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.[217]

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.[218]

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.[219] 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.

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.''[220] No such final regulations have been issued.[221]

HOUSE BILL

The provision makes the following modifications to the present law charitable deduction rules.

[208] 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.

[209] 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.

[210] 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.

[211] Sec. 170(l).

[212] Treas. Reg. sec. 1.170A–1(g).

[213] Sec. 170(j).

[214] Sec. 170(i).

[215] 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.

[216] Sec. 170(f)(17).

[217] 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).

[218] Sec. 6115.

[219] Sec. 170(f)(11).

[220] See IRS, Notice of Proposed Rulemaking, Substantiation Requirement for Certain Contributions, REG–138344–13 (October 13, 2015), I.R.B. 2015–41 (preamble).

[221] 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).

Increased percentage limit 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.

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 charitable 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

SENATE AMENDMENT

The Senate amendment includes three of the House bill's four modifications to the present-law charitable contribution rules: (1) the increase in the percentage limit for charitable contributions of cash to public charities; (2) the denial of a charitable deduction for payments made in exchange for college athletic event seating rights; and (3) the repeal of the substantiation exception for certain contributions reported by the donee organization.

The Senate amendment does not include the provision from the House bill that allows the charitable standard mileage rate to be adjusted for inflation.

Effective date.—The provisions that increase the charitable contribution percentage limit and deny a deduction for stadium seating payments are effective for contributions made in taxable years beginning after December 31, 2017. The provision that repeals the substantiation exception for certain contributions reported by the donee organization is effective for contributions made in taxable years beginning after December 31, 2016.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Repeal of Certain Miscellaneous Itemized Deductions Subject to the Two-Percent Floor (secs. 1307 and 1312 of the House bill, sec. 11045 of the Senate amendment, and secs. 62, 67 and 212 of the Code)

PRESENT LAW

Individuals may claim itemized deductions for certain miscellaneous expenses. Certain of these expenses are not deductible unless, in aggregate, they exceed two percent of the taxpayer's adjusted gross income (''AGI'').[222] The deductions described below are subject to the aggregate two-percent floor.[223]

Expenses for the production or collection of income

Individuals may deduct all ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.[224]

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:[225]

- Appraisal fees for a casualty loss or charitable contribution;
- Casualty and theft losses from property used in performing services as an employee;
- Clerical help and office rent in caring for investments;
- Depreciation on home computers used for investments;
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust;
- Fees to collect interest and dividends;
- Hobby expenses, but generally not more than hobby income;
- Indirect miscellaneous deductions from pass-through entities;
- Investment fees and expenses;
- Loss on deposits in an insolvent or bankrupt financial institution;
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed;
- Repayments of income;
- Safe deposit box rental fees, except for storing jewelry and other personal effects;
- Service charges on dividend reinvestment plans; and
- Trustee's fees for an IRA, if separately billed and paid.

Tax preparation expenses

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.[226]

Unreimbursed expenses attributable to the trade or business of being an employee

In general, unreimbursed 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.[227]

Present law and IRS guidance provide examples of items that may be deducted under this provision. This non-exhaustive list includes:[228]

- 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 perform his job;
- Dues to professional societies;
- Educator expenses;[229]
- 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 fees 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;
- Purchase of 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.

Other miscellaneous itemized deductions subject to the two-percent floor

Other miscellaneous itemized deductions subject to the two-percent floor include:

- Repayments of income received under a claim of right (only subject to the two-percent floor if less than $3,000);
- Repayments of Social Security benefits; and
- The share of deductible investment expenses from pass-through entities.

HOUSE BILL

The House bill repeals the deduction for expenses in connection with the determination, collection, or refund of any tax.

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).

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment suspends all miscellaneous itemized deductions that are subject to the two-percent floor under present law. Thus, under the provision, taxpayers may not claim the above-listed items as itemized deductions for the taxable years to which the suspension applies. The provision does not apply for taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

7. Repeal of deduction for medical expenses (sec. 1308 of the House bill, sec. 11028 of the Senate amendment 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.[230] For taxable years beginning before January 1,

[222] Sec. 67(a).

[223] The miscellaneous itemized deduction for tax preparation expenses is described in a separate section of this document.

[224] Sec. 212(1).

[225] See IRS Publication 529, ''*Miscellaneous Deductions*'' (2016), p. 9.

[226] Sec. 212.

[227] Secs. 62(a)(1) and 67.

[228] See IRS Publication 529, ''*Miscellaneous Deductions*'' (2016), p. 3.

[229] Under a special provision, these expenses are deductible ''above the line'' up to $250.

[230] 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.

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.

HOUSE BILL

The House bill repeals the deduction for unreimbursed medical expenses.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment provides that, for taxable years beginning after December 31, 2016 and ending before January 1, 2019, the threshold for deducting medical expenses shall be 7.5-percent for all taxpayers. For these years, this threshold applies for purposes of the AMT in addition to the regular tax.

Effective date.—The provision is effective for taxable years beginning after December 31, 2016.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

8. Repeal of deduction for alimony payments and corresponding inclusion in gross income (sec. 1309 of the House 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.[231] Child support payments are not treated as alimony.[232]

HOUSE BILL

Under the House bill, alimony and separate maintenance payments are not deductible by the payor spouse. The House bill 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*,[233] 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement generally follows the House bill. However, the conference agreement delays the effective date of the provision by one year. Thus, the conference agreement is effective for any divorce or separation instrument executed after December 31, 2018, or for any divorce or separation instrument executed on or before December 31, 2018, and modified after that date, if the modification expressly provides that the amendments made by this section apply to such modification.

[231] Secs. 215(a), 61(a)(8) and 71(a).

[232] Sec. 71(c).

[233] 245 U.S. 151 (1917).

9. Repeal of deduction for moving expenses (sec. 1310 of the House bill, sec. 11050 of the Senate amendment, and sec. 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.[234] 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.[235] 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.[236] Rules also apply to exclude amounts furnished to the spouse and dependents of such an 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.[237]

HOUSE BILL

The House bill 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.[238] Thus, the provision retains the special rules under present law that provide an exclusion 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.[239]

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment generally suspends the deduction for moving expenses for taxable years 2018 through 2025. However, during that suspension period, the provision retains the deduction for moving expenses and the rules providing for exclusions of 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.

The suspension of the deduction for moving expenses does not apply to taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

[234] Sec. 217(a).

[235] Sec. 217(g).

[236] Sec. 217(g)(2).

[237] Sec. 134.

[238] A technical amendment may be needed to reflect this intent for the deduction for moving expenses for members of the Armed Forces.

[239] Under the provision, these exclusions are added to section 134.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

10. Termination of deduction and exclusions for contributions to medical savings accounts (sec. 1311 of the House bill, 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.[240] 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[241] purposes if made by the employer of an individual.[242]

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 insurance 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

[240] Archer MSAs were originally called medical savings accounts or MSAs.

[241] The FICA exclusion is provided under IRS Notice 96–53.

[242] Sections 106(b) and 220.

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[243] purposes if made by the employer of an individual, and distributions for qualified medical expenses are not includible in gross income.[244] However, the rules for HSAs are in various aspects more favorable than the rules for Archer MSAs. 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.

HOUSE BILL

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.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not contain the House bill provision.

[243] The FICA exclusion is provided under IRS Notice 2004–2.

[244] Secs. 106(d) and 223.

11. Denial of deduction for performing artists and certain officials; Modification of deduction for educator expenses (sec. 1312 of the House bill, sec. 11032 of the Senate amendment and sec. 62 of the Code)

PRESENT LAW

In general, unreimbursed 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.[245] 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.[246]

Eligible educators are elementary or secondary school teachers, instructors, counselors, principals, or aides in a school for at least 900 hours during a school year.[247] An eligible educator may take an ''above-the-line'' deduction for ordinary and necessary expenses incurred (1) by reason of participation in professional development courses related to the curriculum or students the educator teaches, or (2) in connection with books, supplies, computer and other equipment, and supplementary materials to be used in the classroom. The deduction may not exceed $250 (for 2017) in expenses, and is indexed for inflation.

HOUSE BILL

The House bill repeals the present-law provisions allowing for above-the-line deductions for expenses of qualified performing artists, expenses of State or local government officials performing services on a fee basis, and expenses of eligible educators.[248]

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment temporarily increases the limit for the deduction of certain expenses of eligible educators, in determining adjusted gross income, to $500. Any deduction for expenses in excess of this amount (under present law generally a miscellaneous itemized deduction subject to the two-percent floor) is suspended.[249]

The provision does not apply to taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision or the Senate amendment provision and retains the present-law above-the-line deduction and limit for certain expenses of eligible educators.

12. Suspension of exclusion for qualified bicycle commuting reimbursement (sec. 11048 of the Senate amendment and secs. 132(f) of the Code)

PRESENT LAW

Qualified bicycle commuting reimbursements of up to $20 per qualifying bicycle commuting month are excludible from an employee's gross income[250]. A qualifying bicycle commuting month is any month during which the employee regularly uses the bicycle for a substantial portion of travel to a place of employment and during which the employee does not receive transportation in a commuter highway vehicle, a transit pass, or qualified parking from an employer.

Qualified reimbursements are any amount received from an employer during a 15-month period beginning with the first day of the calendar year as payment for reasonable expenses during a calendar year. Reasonable expenses are those incurred in a calendar year for the purchase of a bicycle and bicycle improvements, repair, and storage, if the bicycle is regularly used for travel between the employee's residence and place of employment.

Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision suspends the exclusion from gross income and wages for qualified bicycle commuting reimbursements. The exclusion does not apply to taxable years beginning after December 31, 2017 and before January 1, 2026.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

13. Limitation on exclusion for employer-provided housing (sec. 1401 of the House 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.[251] Special rules apply with respect to employees living in foreign camps[252] and lodging furnished by certain educational institutions to employees.[253] 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.

HOUSE BILL

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.[254] The provision also denies any exclusion for employer-provided housing provided to 5% owners,[255] 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

[245] Secs. 62(a)(1) and 67.

[246] 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.

[247] Sec. 62(d)(1).

[248] 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.

[249] Sec. 11045 of the Senate amendment.

[250] Section 132(a)(5) and 132(f)(1)(D).

[251] Sec. 119(a).

[252] Sec. 119(c).

[253] Sec. 119(d).

[254] The compensation threshold is that amount in effect under section 414(q)(1)(B)(i).

[255] As defined in section 416(i)(1)(B)(i).

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

14. Modification of exclusion of gain on sale of a principal residence (sec. 1402 of the House bill, sec. 11047 of the Senate amendment, 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.

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment generally follows the House bill, but does not include the provision that phases out the exclusion for AGI in excess of $250,000 ($500,000 if married filing a joint return). The Senate amendment does not apply to taxable years beginning after December 31, 2025.

Effective date.—The provision is effective for sales and exchanges after December 31, 2017.

CONFERENCE AGREEMENT

No provision.

15. Sunset of exclusion for dependent care assistance programs (sec. 1404 of the House 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[256] is allowed if the assistance is provided pursuant to a separate written plan of an employer that does not discriminate in favor of highly compensated employees[257] 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.

HOUSE BILL

The provision repeals the deduction for qualified tuition and related expenses.

Effective date.—The provision terminates the exclusions from gross income and wages for dependent care assistance programs for taxable years beginning after December 31, 2022.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

16. Repeal of exclusion for qualified moving expense reimbursement (sec. 1405 of the House bill, sec. 11049 of the Senate amendment, and sec. 132(g) of the Code)

PRESENT LAW

Qualified moving expense reimbursements are excluded from an employee's gross income,[258] 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[259] if directly paid or incurred by the employee. However, any such amount actually deducted by the individual is not eligible for this exclusion. Amounts that are excludible from gross income for income tax purposes are also excluded from wages for employment tax purposes.

HOUSE BILL

The provision repeals the exclusion from gross income and wages for qualified moving expense reimbursements except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill except that the exclusion does not apply to taxable years beginning after December 31, 2017 and before January 1, 2026.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

17. Repeal of exclusion for adoption assistance programs (sec. 1406 of the House 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.[260] 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).[261]

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.[262]

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 (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).

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

256 Sec. 129(a).

257 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.

258 Secs. 132(a)(6) and 132(g).

259 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.[259] 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.

260 Sec. 137(a).

261 Sec. 23(d)(1).

262 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.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

E. Simplification and Reform of Savings, Pensions, Retirement

1. Repeal of special rule permitting recharacterization of IRA contributions (sec. 1501 of the House bill, sec. 13611 of the Senate amendment, 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,[263] to which both deductible and nondeductible contributions may be made,[264] and Roth IRAs, to which only nondeductible contributions may be made.[265] 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 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.[266] 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.[267] 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.[268]

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.[269] The amount converted is includible in the taxpayer's income as if a withdrawal had been made.[270] 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[271]) 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).[272]

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.[273] 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.[274] 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 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.[275]

HOUSE BILL

The House bill 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).[276]

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment with a modification. Under the provision, the special rule that allows a contribution to one type of IRA to be recharacterized as a contribution to the other type of IRA does not

263 Sec. 408.

264 Secs. 219(a) and 408(o).

265 Sec. 408A.

266 Sec. 219(g).

267 Basis results from after-tax contributions to traditional IRAs or a rollovers to traditional IRAs of after-tax amounts from another eligible retirement plan.

268 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.

269 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.

270 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.

271 Secs. 401(a), 403(a), 403(b) and 457(b).

272 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.

273 Sec. 408A(d)(6).

274 Treas. Reg. sec. 1.408A–5, Q&A–2(b).

275 Treas. Reg. sec. 1.408A–5, Q&A–9.

276 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.

apply to a conversion contribution to a Roth IRA. Thus, recharacterization cannot be used to unwind a Roth conversion. However, recharacterization is still permitted with respect to other contributions. For example, an individual may make a contribution for a year to a Roth IRA and, before the due date for the individual's income tax return for that year, recharacterize it as a contribution to a traditional IRA.[277]

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 House 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'').[278] 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.[279] In-service distributions 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.[280]

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.[281]

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).[282]

HOUSE BILL

Under the House bill, 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

3. Modification of rules governing hardship distributions (sec. 1503 of the House 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.[283]

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.[284] 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.

HOUSE BILL

Under the House bill, 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

4. Modification of rules relating to hardship withdrawals from cash or deferred arrangements (sec. 1504 of the bill, sec. 11033(c) of the Senate amendment, 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.[285] 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 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.[286] 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.

HOUSE BILL

The House bill 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 is effective for plan years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision or Senate amendment.

5. Extended rollover period for the rollover of plan loan offset amounts in certain cases (sec. 1505 of the bill, sec. 13613 of the Senate amendment, 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.[287] 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.[288]

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.[289] The

[277] In addition, an individual may still make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA, but the provision precludes the individual from later unwinding the conversion through a recharacterization.

[278] Secs. 401(a), 401(k), 403(a), 403(b), and 457(b).

[279] 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).

[280] Secs. 403(b)(7)(A)(ii) and 403(b)(11).

[281] Sec. 401(a)(36) and Treas. Reg. secs. 1.401–1(b)(1)(i) and 1.401(a)–1(b).

[282] Sec. 457(d)(1)(A).

[283] 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.

[284] Treas. Reg. sec. 1.401(k)–1(d)(3).

[285] Sec. 401(k)(2)(B)(i).

[286] Treas. Reg. sec. 1.401(k)–1(d)(3).

[287] Secs. 402(a) and (c), 402A(d), 403(a) and (b), 457(a) and (e)(16).

[288] Sec. 72(t).

[289] Certain distributions are not eligible rollover distributions, such as annuity payments, required

Continued

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.[290] 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.[291] 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 distribution 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.

HOUSE BILL

Under the House bill, 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 is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except that 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 severance from employment.

Effective date.—The provision is effective for plan loan offset amounts treated as distributed in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Modification of nondiscrimination rules for certain plans providing benefits or contributions to older, longer service participants (sec. 1506 of the House 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.[292] 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.[293] 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).[294] 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'').[295] 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 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.[296] 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

minimum distributions, hardship distributions, and loans that are treated as deemed distributions under section 72(p).

[290] Treas. Reg. sec. 1.402(c)–2, Q&A–1(b)(3).

[291] Sec. 72(p).

[292] 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.

[293] Sec. 401(a)(26).

[294] 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.

[295] 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.

[296] 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 contributions. (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.

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.[297]

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.[298]

The nondiscrimination rules allow contributions and benefit accruals to be provided to highly compensated and nonhighly compensated employees at the same percentage of compensation.[299] 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 calculating an employee's contribution or accrual rate, credit may be given for the employer paid portion of Social Security taxes or benefits.[300] 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 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.[301] The plan coverage and other nondiscrimination requirements are applied separately to the portions of a multiple-employer plan covering employees of different employers.[302]

Certain tax-exempt charitable organizations may offer their employees a tax-deferred annuity plan ("section 403(b) plan").[303] 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.[304] 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 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.[305] 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.

[297] Sec. 410(b)(6)(C).

[298] Secs. 401(k) and (m), the latter of which applies also to after-tax employee contributions under a defined contribution plan.

[299] For this purpose, under section 401(a)(17), compensation generally is limited to $265,000 per year (for 2016).

[300] 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.

[301] 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.

[302] Treas. Reg. sec. 1.413–2(a)(3)(ii)–(iii).

[303] 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.

[304] Treas. Reg. sec. 1.410(b)–7(f).

[305] 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).

HOUSE BILL

Closed or frozen defined benefit plans

In general

Under the House bill, nondiscrimination relief applies with respect to benefits, rights, and features for a closed class of participants (''closed class''),[306] 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,[307] 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;[308] 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.

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,[309] 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.

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.[310] 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 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

[306] 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.

[307] Other testing options available under present law are also available for this purpose.

[308] 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.

[309] Other testing options available under present law are also available for this purpose.

[310] 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.

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.[311] 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 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.

[311] For this purpose, consistency is not required with respect to employees who were subject to different benefit formulas under the defined benefit plan.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

7. Modification of rules applicable to length of service award programs for bona fide public safety volunteers (sec. 13612 of the Senate amendment and sec. 457(e) of the Code)

PRESENT LAW

Special rules apply to deferred compensation plans of State and local government and private, tax-exempt employers.[312] However, an exception to these rules applies in the case of a plan paying solely length of service awards to bona fide volunteers (or their beneficiaries) on account of qualified services performed by the volunteers. For this purpose, qualified services consist of firefighting and fire prevention services, emergency medical services, and ambulance services. An individual is treated as a bona fide volunteer for this purpose if the only compensation received by the individual for performing qualified services is in the form of (1) reimbursement or a reasonable allowance for reasonable expenses incurred in the performance of such services, or (2) reasonable benefits (including length of service awards) and nominal fees for the services, customarily paid in connection with the performance of such services by volunteers. The exception applies only if the aggregate amount of length of service awards accruing for a bona fide volunteer with respect to any year of service does not exceed $3,000.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the aggregate amount of length of service awards that may accrue for a bona fide volunteer with respect to any year of service to $6,000 and adjusts that amount in $500 increments to reflect changes in cost-of-living for years after the first year the provision is effective. In addition, under the provision, if the plan is a defined benefit plan, the limit applies to the actuarial present value of the aggregate amount of length of service awards accruing with respect to any year of service. Actuarial present value is to be calculated using reasonable actuarial assumptions and methods, assuming payment will be made under the most valuable form of payment under the plan with payment commencing at the later of the earliest age at which unreduced benefits are payable under the plan or the participant's age at the time of the calculation.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

F. Modifications to Estate, Gift, and Generation-Skipping Transfers Taxes (secs. 1601 and 1602 of the House bill, sec. 11061 of the Senate amendment, and secs. 2001 and 2010 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.

[312] Sec. 457.

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.[313]

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.[314] 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.[315] For 2017, the inflation-indexed exemption amount is $5.49 million.[316] 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.[317] 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

[313] Sec. 102.

[314] Sec. 2010.

[315] 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.

[316] For 2017, the $5.49 million exemption amount results in a unified credit of $2,141,800, after applying the applicable rates set forth in section 2001(c).

[317] Secs. 2056 and 2523.

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 marital 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.[318] 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.[319] 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.[320]

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.[321] 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.[322]

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.

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.[323] 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).[324]

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.[325] 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;[326] (2) certain transfers of property in which the decedent retained a life estate;[327] (3) certain transfers taking effect at death;[328] and (4) revocable transfers.[329] 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).[330] 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.[331]

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.[332] 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.

Other deductions.—A deduction is available for funeral expenses, estate administration expenses, and claims against the estate, including certain taxes.[333] A deduction also is available for uninsured casualty and theft losses incurred during the settlement of the estate.[334]

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.[335] 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);[336] (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);[337] 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).[338]

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.[339] 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 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 imposed to recapture the entire estate-tax benefit of the special-use valuation.

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).[340] 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

318 Secs. 2055 and 2522.

319 Sec. 2055(d).

320 Secs. 2055(e)(2) and 2522(c)(2).

321 Sec. 2001(a).

322 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.

323 Sec. 2031(a).

324 Sec. 2032.

325 Sec. 2033.

326 Sec. 2035.

327 Sec. 2036.

328 Sec. 2037.

329 Sec. 2038.

330 Sec. 2041.

331 Sec. 2042.

332 Sec. 2058.

333 Sec. 2053.

334 Sec. 2054.

335 Sec. 2010.

336 Sec. 2012.

337 Sec. 2013.

338 Sec. 2014. In certain cases, an election may be made to deduct foreign death taxes. See section 2053(d).

339 Sec. 2032A.

340 Sec. 6166.

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).[341] 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.[342] 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.

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.[343] 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.[344] 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.[345]

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,[346] transfers to section 527 political organizations,[347] and transfers to tax-exempt organizations described in sections 501(c)(4), (5), or (6).[348]

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.[349] If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $28,000 per donee 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.[350]

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.[351] 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).

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

[341] The interest rate on this portion adjusts with the Federal short-term rate.

[342] Sec. 2501(a).

[343] Sec. 2511(a).

[344] Sec. 2512(a).

[345] Sec. 2512(b).

[346] Sec. 2503(e).

[347] Sec. 2501(a)(4).

[348] Sec. 2501(a)(6).

[349] Sec. 2503(b).

[350] Sec. 529(c)(2).

[351] 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.

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).

HOUSE BILL

The provision doubles the estate and gift tax exemption 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.

SENATE AMENDMENT

The provision doubles the estate and gift tax exemption for estates of decedents dying and gifts made after December 31, 2017, and before January 1, 2026. 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.

As a conforming amendment to section 2010(g) (regarding computation of estate tax), the provision provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out the purposes of the section with respect to differences between the basic exclusion amount in effect: (1) at the time of the decedent's death; and (2) at the time of any gifts made by the decedent.

Effective date.—The provision is effective for estates of decedents dying and gifts made after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

G. Alternative Minimum Tax (sec. 2001 of the House bill, sec. 12001 of the Senate amendment, and secs. 53 and 55–59 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

HOUSE BILL

The House bill 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 is effective for 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.

SENATE AMENDMENT

The Senate amendment temporarily increases both the exemption amount and the exemption amount phaseout thresholds for the individual AMT. Under the provision, for taxable years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount is increased to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $208,400 (half this amount for married taxpayers filing a separate return), and $156,300 for all other taxpayers (other than estates and trusts). These amounts are indexed for inflation.

The provision does not change the corporate alternative minimum tax.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement temporarily increases both the exemption amount and the exemption amount phaseout thresholds for the individual AMT. Under the provision, for taxable years beginning after December 31, 2017, and beginning before January 1, 2026, the AMT exemption amount is increased to $109,400 for married taxpayers filing a joint return (half this amount for married taxpayers filing a separate return), and $70,300 for all other taxpayers (other than estates and trusts). The phaseout thresholds are increased to $1,000,000 for married taxpayers filing a joint return, and $500,000 for all other taxpayers (other than estates and trusts). These amounts are indexed for inflation.

The conference agreement follows the House bill in repealing the corporate alternative minimum tax.

In the case of a corporation, the conference agreement allows the AMT credit to offset the regular tax liability for any taxable year. In addition, the AMT credit is refundable for any taxable year beginning after 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2021) 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 2022.

Effective date.—The provisions are effective for taxable years beginning after December 31, 2017.

H. Elimination of Shared Responsibility Payment for Individuals Failing to Maintain Minimal Essential Coverage (sec. 11081 of the Senate amendment and sec. 5000A of the Code)

PRESENT LAW

Under the Patient Protection and Affordable Care Act[352] (also called the Affordable Care Act, or ''ACA''), individuals must be covered by a health plan that provides at least minimum essential coverage or be subject to a tax (also referred to as a penalty) for failure to maintain the coverage (commonly referred to as the ''individual mandate'').[353] Minimum essential coverage includes government-sponsored programs (including Medicare, Medicaid, and CHIP, among others), eligible employer-sponsored plans, plans in the individual market, grandfathered group health plans and grandfathered health insurance coverage, and other coverage as recognized by the Secretary of Health and Human Services (''HHS'') in coordination with the Secretary of the Treasury.[354] The tax is imposed for any month that an individual does not have minimum essential coverage unless the individual qualifies for an exemption for the month as described below.

The tax for any calendar month is one-twelfth of the tax calculated as an annual amount. The annual amount is equal to the greater of a flat dollar amount or an excess income amount. The flat dollar amount is the lesser of (1) the sum of the individual annual dollar amounts for the members of the taxpayer's family and (2) 300 percent of the adult individual dollar amount. The individual adult annual dollar amount is $695 for 2017 and 2018.[355] For an individual who has not attained age 18, the individual annual dollar amount is one half of the adult amount. The excess income amount is 2.5 percent of the excess of the taxpayer's household income for the taxable year over the threshold amount of income for requiring the taxpayer to file an income tax return.[356] The total annual household payment may not exceed the national average annual premium for bronze level health plans for the applicable family size offered through Exchanges that year.

Exemptions from the requirement to maintain minimum essential coverage are provided for the following: (1) an individual for whom coverage is unaffordable because the required contribution exceeds 8.16[357] percent of household income, (2) an individual with household income below the income tax return filing threshold, (3) a member of an Indian tribe, (4) a member of certain recognized religious sects or a health sharing ministry, (5) an individual with a coverage gap for a continuous period of less than three months, and (6) an individual who is determined by the Secretary of HHS to have suffered a hardship with respect to the capability to obtain coverage.[358]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment reduces the amount of the individual responsibility payment, enacted as part of the Affordable Care Act, to zero.

Effective date.—The provision is effective with respect to health coverage status for months beginning after December 31, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

I. Other Provisions

1. Temporarily allow increased contributions to ABLE accounts, and allow contributions to be eligible for saver's credit (sec. 11024 of the Senate amendment and sec. 529A of the Code)

PRESENT LAW

Qualified ABLE programs

The Code provides for a tax-favored savings program intended to benefit disabled individuals, known as qualified ABLE programs.[359] 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.[360] 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 beneficiary. 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.[361] Distributions from an ABLE account are excludable from income to the extent that the total distribution does not exceed the qualified disability expenses of

[352] Pub. L. No. 111–148.

[353] Section 5000A. If an individual is a dependent, as defined in section 152, of another taxpayer, the other taxpayer is liable for any tax for failure to maintain the required coverage with respect to the individual.

[354] Sec. 5000A(f). Minimum essential coverage does not include coverage that consists of only certain excepted benefits, such as limited scope dental and vision benefits or long-term care insurance offered under a separate policy, certificate or contract.

[355] For years after 2016, the $695 amount is indexed to CPI–U, rounded to the next lowest multiple of $50.

[356] Sec. 6012(a).

[357] For 2017. The rate applicable for 2018 is 8.06 percent of household income.

[358] In addition, certain individuals present or residing outside of the United States and bona fide residents of United States territories are deemed to maintain minimum essential coverage.

[359] Sec. 529A.

[360] 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.

[361] The rules of section 72 apply in determining the portion of a distribution that consists of earnings.

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[362] 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,[363] 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[364] 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 Security 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.[365]

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.

Saver's credit

Present law provides a nonrefundable tax credit for eligible taxpayers for qualified retirement savings contributions.[366] The maximum annual contribution eligible for the credit is $2,000 per individual. The credit rate depends on the adjusted gross income (''AGI'') of the taxpayer. For this purpose, AGI is determined without regard to certain excludable foreign-source earned income and certain U.S. possession income.

For taxable years beginning in 2017, married taxpayers filing joint returns with AGI of $61,500 or less, taxpayers filing head of household returns with AGI of $46,125 or less, and all other taxpayers filing returns with AGI of $30,750 or less are eligible for the credit. As the taxpayer's AGI increases, the credit rate available to the taxpayer is reduced, until, at certain AGI levels, the credit is unavailable. The credit rates based on AGI for taxable years beginning in 2016 are provided in the table below. The AGI levels used for the determination of the available credit rate are indexed for inflation.

TABLE 3.—CREDIT RATES FOR SAVER'S CREDIT

Joint Filers	Heads of Households	All Other Filers	Credit Rate
$0–$37,000	$0–$27,750	$0–$18,500	50 percent
$37,001–$40,000	$27,751–$30,000	$18,501–$20,000	20 percent
$40,001–$62,000	$30,001–$46,500	$20,001–$31,000	10 percent
Over $62,000	Over $46,500	Over $31,000	0 percent

The saver's credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets alternative minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 years old or older, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

Qualified retirement savings contributions consist of (1) elective deferrals to a section 401(k) plan, a section 403(b) plan, a governmental section 457 plan, a SIMPLE plan, or a SARSEP; (2) contributions to a traditional or Roth IRA; and (3) voluntary after-tax employee contributions to a qualified retirement plan or section 403(b) plan. Under the rules governing these arrangements, an individual's contribution to the arrangement generally cannot exceed the lesser of an annual dollar amount (for example, in 2017, $5,500 in the case of an IRA of an individual under age 50) or the individual's compensation that is includible in income. In the case of IRA contributions of a married couple, the combined includible compensation of both spouses may be taken into account.

The amount of any contribution eligible for the credit is reduced by distributions received by the taxpayer (or by the taxpayer's spouse if the taxpayer files a joint return with the spouse) from any retirement plan to which eligible contributions can be made during the taxable year for which the credit is claimed, during the two taxable years prior to the year for which the credit is claimed, and during the period after the end of the taxable year for which the credit is claimed and prior to the due date (including extensions) for filing the taxpayer's return for the year. Distributions that are rolled over to another retirement plan do not affect the credit.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment temporarily increases the contribution limitation to ABLE accounts under certain circumstances. While the general overall limitation on contributions (the per-donee annual gift tax exclusion ($14,000 for 2017)) remains the same, the limitation is temporarily increased with respect to contributions made by the designated beneficiary of the ABLE account. Under the temporary provision, after the overall limitation on contributions is reached, an ABLE account's designated beneficiary may contribute an additional amount, up to the lesser of (a) the Federal poverty line for a one-person household; or

[362] For instance, if a designated beneficiary were to relocate to a different State.

[363] In which case the contributor ABLE account must be closed 60 days after the transfer to the new ABLE account is made.

[364] These are benefits, respectively, under Title II or Title XVI of the Social Security Act.

[365] No inference may be drawn from a disability certification for purposes of eligibility for Social Security, SSI or Medicaid benefits.

[366] Sec. 25B.

(b) the individual's compensation for the taxable year.

Additionally, the provision temporarily allows a designated beneficiary of an ABLE account to claim the saver's credit for contributions made to his or her ABLE account.

The provision does not apply to taxable years after December 31, 2025.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

Effective date.—The provision is effective for taxable years beginning after the date of enactment of this Act.

2. Extension of time limit for contesting IRS levy (sec. 11071 of the Senate amendment and secs. 6343 and 6532 of the Code)

PRESENT LAW

The IRS is authorized to return property that has been wrongfully levied upon.[367] In general, monetary proceeds from the sale of levied property may be returned within nine months of the date of the levy.

Generally, any person (other than the person against whom is assessed the tax out of which such levy arose) who claims an interest in levied property and that such property was wrongfully levied upon may bring a civil action for wrongful levy in a district court of the United States.[368] Generally, an action for wrongful levy must be brought within nine months from the date of levy.[369]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision extends from nine months to two years the period for returning the monetary proceeds from the sale of property that has been wrongfully levied upon.

The provision also extends from nine months to two years the period for bringing a civil action for wrongful levy.

Effective date.—The provision is effective with respect to: (1) levies made after the date of enactment; and (2) levies made on or before the date of enactment provided that the nine-month period has not expired as of the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

3. Treatment of certain individuals performing services in the Sinai Peninsula of Egypt (sec. 11026 of the Senate amendment and secs. 2, 112, 692, 2201, 3401, 4253, 6013, and 7508 of the Code)

PRESENT LAW

Members of the Armed Forces serving in a combat zone are afforded a number of tax benefits. These include:

1. An exclusion from gross income of certain military pay received for any month during which the member served in a combat zone or was hospitalized as a result of serving in a combat zone;[370]

2. An exemption from taxes on death while serving in combat zone or dying as a result of wounds, disease, or injury incurred while so serving;[371]

3. Special estate tax rules where death occurs in a combat zone;[372]

4. Special benefits to surviving spouses in the event of a service member's death or missing status;[373]

5. An extension of time limits governing the filing of returns and other rules regarding timely compliance with Federal income tax rules;[374] and

6. An exclusion from telephone excise taxes.[375]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision grants combat zone tax benefits to the Sinai Peninsula of Egypt, if as of the date of enactment of the provision any member of the Armed Forces of the United States is entitled to special pay under section 310 of title 37, United States Code (relating to special pay; duty subject to hostile fire or imminent danger), for services performed in such location. This benefit lasts only during the period such entitlement is in effect but not later than taxable years beginning before January 1, 2026.

Effective date.—The provision is generally effective beginning June 9, 2015. The portion of the provision related to wage withholding applies to remuneration paid after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

4. Modifications of user fees requirements for installment agreements (sec. 11073 of the Senate amendment and new sec. 6159(f) of the Code)

PRESENT LAW

The Code authorizes the IRS to enter into written agreements with any taxpayer under which the taxpayer agrees to pay taxes owed, as well as interest and penalties, in installments over an agreed schedule, if the IRS determines that doing so will facilitate collection of the amounts owed. This agreement provides for a period during which payments may be made and while other IRS enforcement actions are held in abeyance.[376] An installment agreement generally does not reduce the amount of taxes, interest, or penalties owed. However, the IRS is authorized to enter into installment agreements with taxpayers which do not provide for full payment of the taxpayer's liability over the life of the agreement. The IRS is required to review such partial payment installment agreements at least every two years to determine whether the financial condition of the taxpayer has significantly changed so as to warrant an increase in the value of the payments being made.

Taxpayers can request an installment agreement by filing Form 9465, Installment Agreement Request.[377] If the request for an installment agreement is approved by the IRS, the IRS charges a user fee.[378] The IRS currently charges $225 for entering into an installment agreement.[379] If the application is for a direct debit installment agreement, whereby the taxpayer authorizes the IRS to request the monthly electronic transfer of funds from the taxpayer's bank account to the IRS, the fee is reduced to $107.[380] In addition, regardless of the method of payment, the fee is $43 for low-income taxpayers.[381] For this purpose, low-income is defined as a person who falls below 250 percent of the Federal poverty guidelines published annually. Finally, there is no user fee if the agreement qualifies for a short term agreement (120 days or less).

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision generally prohibits increases in the amount of user fees charged by the IRS for installment agreements. For low-income taxpayers (those whose income falls below 250 percent of the Federal poverty guidelines), it alleviates the user fee requirement in two ways. First, it waives the user fee if the low-income taxpayer enters into an installment agreement under which the taxpayer agrees to make automated installment payments through a debit account. Second, it provides that low-income taxpayers who are unable to agree to make payments electronically remain subject to the required user fee, but the fee is reimbursed upon completion of the installment agreement.

Effective date.—The provision is effective for agreements entered into on or after the date that is 60 days after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

5. Relief for 2016 disaster areas (sec. 11029 of the Senate amendment and secs. 72(t), 165, 401–403, 408, 457, and 3405 of the Code)

PRESENT LAW

Distributions from tax-favored retirement plans

A distribution from a qualified retirement plan, a tax-sheltered annuity plan (a "section 403(b) plan"), an eligible deferred compensation plan of a State or local government employer (a "governmental section 457(b) plan"), or an individual retirement arrangement (an "IRA") generally is included in income for the year distributed.[382] These plans are referred to collectively as "eligible retirement plans." In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10-percent additional tax (referred to as the "early withdrawal tax") on the amount includible in income.[383]

In general, a distribution from an eligible retirement plan may be rolled over to another eligible retirement plan within 60 days, in which case the amount rolled over generally is not includible in income. The IRS has the authority to waive the 60-day requirement if failure to waive the requirement would be against equity or good conscience, including cases of casualty, disaster or other events beyond the reasonable control of the individual.

The terms of a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan generally determine when distributions are permitted. However, in some

367 Sec. 6343.

368 Sec. 7426.

369 Sec. 6532.

370 Sec. 112; see also, sec. 3401(a)(1), exempting such income from wage withholding.

371 Sec. 692.

372 Sec. 2201.

373 Secs. 2(a)(3) and 6013(f)(1).

374 Sec. 7508.

375 Sec. 4253(d).

376 Sec. 6331(k).

377 The IRS accepts applications for installment agreements online, from individuals and businesses, if the total tax, penalties and interest is below $50,000 for the former, and $25,000 for the latter.

378 31 U.S.C. sec. 9701; Treas. reg. sec. 300.1; The Independent Offices Appropriations Act of 1952 (IOAA) 65 Stat. B70 (June 27, 1951). A discussion of the IRS practice regarding user fees and a list of actions for which fees are charged is included in the Internal Revenue Manual. See "User Fees," paragraph 1.32.19 IRM, available at *https://www.irs.gov/irm/part1/irm*_01-035-019.

379 Treas. reg. sec. 300.1.

380 *Ibid*.

381 *Ibid*.

382 Secs. 401(a), 403(a), 403(b), 457(b) and 408. Under section 3405, distributions from these plans are generally subject to income tax withholding unless the recipient elects otherwise. In addition, certain distributions from a qualified retirement plan, a section 403(b) plan, or a governmental section 457(b) plan are subject to mandatory income tax withholding at a 20-percent rate unless the distribution is rolled over.

383 Sec. 72(t). Under present law, the 10-percent early withdrawal tax does not apply to distributions from a governmental section 457(b) plan.

cases, restrictions may apply to distribution before an employee's termination of employment, referred to as ''in-service'' distributions. Despite such restrictions, an in-service distribution may be permitted in the case of financial hardship or an unforeseeable emergency.

Tax-favored retirement plans are generally required to be operated in accordance with the terms of the plan document, and amendments to reflect changes to the plan generally must be adopted within a limited period.

Itemized deduction for casualty losses

A taxpayer may generally claim a deduction for any loss sustained during the taxable year and not compensated by insurance or otherwise.[384] 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. 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.

HOUSE BILL

No provision.

SENATE AMENDMENT

In general

The provision provides tax relief, as described below, relating to a ''2016 disaster area,'' defined as any area with respect to which a major disaster was declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016.

Distributions from eligible retirement plans

Under the provision, an exception to the 10-percent early withdrawal tax applies in the case of a qualified 2016 disaster distribution from a qualified retirement plan, a section 403(b) plan or an IRA. In addition, as discussed further, income attributable to a qualified 2016 disaster distribution may be included in income ratably over three years, and the amount of a qualified 2016 disaster distribution may be recontributed to an eligible retirement plan within three years.

A qualified 2016 disaster distribution is a distribution from an eligible retirement plan made on or after January 1, 2016, and before January 1, 2018, to an individual whose principal place of abode at any time during calendar year 2016 was located in a 2016 disaster area and who has sustained an economic loss by reason of the events giving rise to the Presidential disaster declaration.

The total amount of distributions to an individual from all eligible retirement plans that may be treated as qualified 2016 disaster distributions is $100,000. Thus, any distributions in excess of $100,000 during the applicable period are not qualified 2016 disaster distributions.

Any amount required to be included in income as a result of a qualified 2016 disaster is included in income ratably over the three-year period beginning with the year of distribution unless the individual elects not to have ratable inclusion apply.

Any portion of a qualified 2016 disaster distribution may, at any time during the three-year period beginning the day after the date on which the distribution was received, be recontributed to an eligible retirement plan to which a rollover can be made. Any amount recontributed within the three-year period is treated as a rollover and thus is not includible in income. For example, if an individual receives a qualified 2016 disaster distribution in 2016, that amount is included in income, generally ratably over the year of the distribution and the following two years, but is not subject to the 10-percent early withdrawal tax. If, in 2018, the amount of the qualified 2016 disaster distribution is recontributed to an eligible retirement plan, the individual may file an amended return to claim a refund of the tax attributable to the amount previously included in income. In addition, if, under the ratable inclusion provision, a portion of the distribution has not yet been included in income at the time of the contribution, the remaining amount is not includible in income.

A qualified 2016 disaster distribution is a permissible distribution from a qualified retirement plan, section 403(b) plan, or governmental section 457(b) plan, regardless of whether a distribution otherwise would be permissible.[385] A plan is not treated as violating any Code requirement merely because it treats a distribution as a qualified 2016 disaster distribution, provided that the aggregate amount of such distributions from plans maintained by the employer and members of the employer's controlled group or affiliated service group does not exceed $100,000. Thus, a plan is not treated as violating any Code requirement merely because an individual might receive total distributions in excess of $100,000, taking into account distributions from plans of other employers or IRAs.

A plan amendment made pursuant to the provision (or a regulation issued thereunder) may be retroactively effective if, in addition to the requirements described below, the amendment is made on or before the last day of the first plan year beginning after December 31, 2018 (or in the case of a governmental plan, December 31, 2020), or a later date prescribed by the Secretary. In addition, the plan will be treated as operated in accordance with plan terms during the period beginning with the date the provision or regulation takes effect (or the date specified by the plan if the amendment is not required by the provision or regulation) and ending on the last permissible date for the amendment (or, if earlier, the date the amendment is adopted). In order for an amendment to be retroactively effective, it must apply retroactively for that period, and the plan must be operated in accordance with the amendment during that period.

Modification of rules related to casualty losses

Under the provision, in the case of a personal casualty loss which arose on or after January 1, 2016, in a 2016 disaster area and was attributable to the events giving rise to the Presidential disaster declaration, such losses are deductible without regard to whether aggregate net losses exceed ten percent of a taxpayer's adjusted gross income. Under the provision, in order to be deductible, the losses must exceed $500 per casualty. Additionally, such losses may be claimed in addition to the standard deduction.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with a clarification that casualty loss relief applies to losses arising in taxable years beginning after December 31, 2015, and before January 1, 2018.

6. Attorneys' fees relating to awards to whistleblowers (sec. 11078 of the Senate amendment and sec. 62(a)(21) of the Code)

PRESENT LAW

The Code provides an above-the-line deduction for attorneys' fees and costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination, certain claims against the Federal Government, or a private cause of action under the Medicare Secondary Payer statute.[386] The amount that may be deducted above-the-line may not exceed the amount includible in the taxpayer's gross income for the taxable year on account of a judgment or settlement (whether by suit or agreement and whether as lump sum or periodic payments) resulting from such claim. Additionally, the Code provides an above-the-line deduction for attorneys' fees and costs paid by, or on behalf of, the individual in connection with any award for providing information regarding violations of the tax laws.[387] The amount that may be deducted above-the-line may not exceed the amount includible in the taxpayer's gross income for the taxable year on account of such award.[388]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision provides an above-the-line deduction for attorney fees and court costs paid by, or on behalf of, the taxpayer in connection with any action involving a claim under State False Claim Acts, the SEC whistleblower program,[389] and the Commodity Future Trading Commission whistleblower program.[390]

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

7. Clarification of whistleblower awards (sec. 11079 of the Senate amendment and new sec. 7623(c) of the Code)

PRESENT LAW

Awards to whistleblowers

The Code authorizes the IRS to pay such sums as deemed necessary for: ''(1) detecting underpayments of tax; or (2) detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same.''[391] Generally, amounts are paid based on a percentage of proceeds collected based on the information provided.

The Tax Relief and Health Care Act of 2006 (the ''Act'')[392] established an enhanced reward program for actions in which the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000 and, if the taxpayer is an individual, the individual's gross income exceeds $200,000 for any taxable year in issue. In such cases, the award is calculated to be at least 15 percent

384 Sec. 165.

385 A qualified 2016 disaster distributions is subject to income tax withholding unless the recipient elects otherwise. Mandatory 20-percent withholding does not apply.

386 Secs. 62(a)(20) and (e). Section 62(e) defines ''unlawful discrimination'' to include a number of specific statutes, any federal whistle-blower statute, and any federal, state, or local law ''providing for the enforcement of civil rights'' or ''regulating any aspect of the employment relationship . . . or prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law.''

387 Secs. 7623 and 62(a)(21).

388 Secs. 7623 and 62(a)(21).

389 15 U.S.C. secs. 78u–6 and 78u–7.

390 7 U.S.C. sec. 26.

391 Sec. 7623.

392 Pub. L. No. 109–432.

but not more than 30 percent of collected proceeds (including penalties, interest, additions to tax, and additional amounts).

The Act permits an individual to appeal the amount or a denial of an award determination to the United States Tax Court (the ''Tax Court'') within 30 days of such determination. Tax Court review of an award determination may be assigned to a special trial judge.

Rules relating to taxpayers with foreign assets

U.S. persons who transfer assets to, and hold interests in, foreign bank accounts or foreign entities may be subject to self-reporting requirements under both the Foreign Account Tax Compliance Act provisions in the Code and the provisions in the Bank Secrecy Act and its underlying regulations (which provide for FinCEN Form 114, Report of Foreign Bank and Financial Accounts, the ''FBAR''), as discussed below. Amounts recovered for violations of FATCA provisions in the Code may be considered for purposes of computing a whistleblower award under the Code. However, the IRS has found that amounts recovered for violations of non-tax laws, including the provisions of the Bank Secrecy Act (and FBAR) for which the IRS has delegated authority, may not be considered for purposes of computing an award under the Code.[393]

Foreign Account Tax Compliance Act (''FATCA'')

The Code imposes a withholding and reporting regime for U.S. persons engaged in foreign activities, directly or indirectly, through a foreign business entity.[394] This regime for outbound payments,[395] commonly referred to as the Foreign Account Tax Compliance Act (''FATCA''),[396] imposes a withholding tax of 30 percent of the gross amount of certain payments to foreign financial institutions (''FFIs'') unless the FFI establishes that it is compliant with the information reporting requirements of FATCA which include identifying certain U.S. accounts held in the FFI. An FFI must report with respect to a U.S. account (1) the name, address, and taxpayer identification number of each U.S. person holding an account or a foreign entity with one or more substantial U.S. owners holding an account; (2) the account number; (3) the account balance or value; and (4) except as provided by the Secretary, the gross receipts, including from dividends and interest, and gross withdrawals or payments from the account.[397]

Individuals are required to disclose with their annual Federal income tax return any interest in foreign accounts and certain foreign securities if the aggregate value of such assets is in excess of the greater of $50,000 or an amount determined by the Secretary in regulations. Failure to do so is punishable by a penalty of $10,000, which may increase for each 30-day period during which the failure continues after notification by the IRS, up to a maximum penalty of $50,000.[398]

Report of Foreign Bank and Financial Accounts (the ''FBAR'')

In addition to the reporting requirements under the Code, U.S. persons who transfer assets to, and hold interests in, foreign bank accounts or foreign entities may be subject to self-reporting requirements under the Bank Secrecy Act.[399]

The Bank Secrecy Act imposes reporting obligations on both financial institutions and account holders. With respect to account holders, a U.S. citizen, resident, or person doing business in the United States is required to keep records and file reports, as specified by the Secretary, when that person enters into a transaction or maintains an account with a foreign financial agency.[400] Regulations promulgated pursuant to broad regulatory authority granted to the Secretary in the Bank Secrecy Act[401] provide additional guidance regarding the disclosure obligation with respect to foreign accounts.

The FBAR must be filed by June 30[402] of the year following the year in which the $10,000 filing threshold is met.[403] Failure to file the FBAR is subject to both criminal[404] and civil penalties.[405] Willful failure to file an FBAR may be subject to penalties in amounts not to exceed the greater of $100,000 or 50 percent of the amount in the account at the time of the violation.[406] A non-willful, but negligent, failure to file is subject to a penalty of $10,000 for each negligent violation.[407] The penalty may be waived if (1) there is reasonable cause for the failure to report and (2) the amount of the transaction or balance in the account was properly reported. In addition, serious violations are subject to criminal prosecution, potentially resulting in both monetary penalties and imprisonment. Civil and criminal sanctions are not mutually exclusive.

FBAR enforcement responsibility

Until 2003, the Financial Crimes Enforcement Network (''FinCEN''), an agency of the Department of the Treasury, had exclusive responsibility for civil penalty enforcement of FBAR, although administration of the FBAR reporting regime was delegated to the IRS.[408] As a result, persons who were more than 180 days delinquent in paying any FBAR penalties were referred for collection action to the Financial Management Service of the Treasury Department, which is responsible for such non-tax collections.[409] Continued nonpayment resulted in a referral to the Department of Justice for institution of court proceedings against the delinquent person. In 2003, the Secretary delegated FBAR civil enforcement authority to the IRS.[410] The authority delegated to the IRS in 2003 included the authority to determine and enforce civil penalties,[411] as well as to revise the form and instructions. However, the Bank Secrecy Act does not include collection powers similar to those available for enforcement of the tax laws under the Code. As a consequence, FBAR civil penalties remain collectible only in accord with the procedures for non-tax collection described above.

FBAR and awards to whistleblowers

Recent cases have considered FBAR penalties in connection with IRS whistleblower awards.[412] One case analyzed the provision dealing with ''additional amounts in dispute'' and linked that concept to amounts assessed and collected under the Code which FBAR is not.[413] The issue was whether FBAR penalties constituted ''additional amounts'' for purposes of determining whether ''additional amounts in dispute exceed $2,000,000.'' The case was disposed on summary judgment on the grounds that FBAR penalties are not assessed, collected or paid in the same manner as taxes. As such, they are not additional amounts in dispute and therefore the threshold was not exceeded. Notably, the court suggested that the petitioner present its policy arguments to Congress based on the fact that the connection between FBAR and tax enforcement justified the Secretary to redelegate FBAR administrative authority to the IRS.[414]

Another case dealt with the provision ''collected proceeds'' and held that the term is not limited to amounts assessed and collected under Title 26.[415] The issue in the case was whether payments of a criminal fine and civil forfeitures constitute collected proceeds.

The criminal fine was imposed under Title 18 as a result of guilty plea to conspiring to defraud the IRS, file false Federal income tax returns, and evade Federal income taxes.

[393] Chief Counsel Memorandum, ''Scope of Awards Payable Under I.R.C. section 7623,'' April 23, 2012, available at *http://www.tax-whistleblower.com/resources/PMTA-2012-10.pdf*. Under Title 31, ''[t]he Secretary may pay a reward to an individual who provides original information which leads to a recovery of a criminal fine, civil penalty, or forfeiture, which exceeds $50,000, for a violation of [chapter 53 of Title 31]. The Secretary shall determine the amount of a reward . . . [and] may not award more than 25 per centum of the net amount of the fine, penalty, or forfeiture collected or $150,000, whichever is less.'' 31 U.S.C. §5323.

[394] See, *e.g.*, secs. 6038, 6038B, and 6046.

[395] Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111–147.

[396] Foreign Account Tax Compliance Act of 2009 is the name of the House and Senate bills in which the provisions first appeared. See H.R. 3933 and S. 1934 (October 27, 2009).

[397] Sec. 1471(c).

[398] Sec. 6038D. Guidance on the scope of reporting required, the threshold values triggering reporting requirements for various fact patterns and how the value of assets is to be determined is found in Treas. Reg. secs. 1.6038D–1 to 1.6038D–8.

[399] Bank Secrecy Act, 31 U.S.C. secs. 5311–5332.

[400] 31 U.S.C. sec. 5314. The term ''agency'' in the Bank Secrecy Act includes financial institutions.

[401] 31 U.S.C. sec. 5314(a) provides: ''Considering the need to avoid impeding or controlling the export or import of monetary instruments and the need to avoid burdening unreasonably a person making a transaction with a foreign financial agency, the Secretary of the Treasury shall require a resident or citizen of the United States or a person in, and doing business in, the United States, to keep records, file reports, or keep records and file reports, when the resident, citizen, or person makes a transaction or maintains a relation for any person with a foreign financial agency.''

[402] The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114–41, changed the filing date for FinCEN Form 114 from June 30 to April 15 (with a maximum extension for a 6-month period ending on October 15 and with provision for an extension under rules similar to the rules in Treas. Reg. section 1.6081—5) for tax returns for taxable years beginning after December 31, 2015.

[403] 31 C.F.R. sec. 103.27(c). The $10,000 threshold is the aggregate value of all foreign financial accounts in which a U.S. person has a financial interest or over which the U.S. person has signature or other authority.

[404] 31 U.S.C. sec. 5322 (failure to file is punishable by a fine up to $250,000 and imprisonment for five years, which may double if the violation occurs in conjunction with certain other violations).

[405] 31 U.S.C. sec. 5321(a)(5).

[406] 31 U.S.C. sec. 5321(a)(5)(C).

[407] 31 U.S.C. sec. 5321(a)(5)(B)(i), (ii).

[408] Treas. Directive 15–14 (December 1, 1992), in which the Secretary delegated to the IRS authority to investigate violations of the Bank Secrecy Act. If the IRS Criminal Investigation Division declines to pursue a possible criminal case, it is to refer the matter to FinCEN for civil enforcement.

[409] 31 U.S.C. sec. 3711(g).

[410] 31 C.F.R. sec. 103.56(g). Memorandum of Agreement and Delegation of Authority for Enforcement of FBAR Requirements (April 2, 2003); News Release, Internal Revenue Service, IR–2003–48 (April 10, 2003). Secretary of the Treasury, ''A Report to Congress in Accordance with sec. 361(b) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA Patriot Act)'' (April 24, 2003).

[411] A penalty may be assessed before the end of the six-year period beginning on the date of the transaction with respect to which the penalty is assessed. 31 U.S.C. sec. 5321(b)(1). A civil action for collection may be commenced within two years of the later of the date of assessment and the date a judgment becomes final in any a related criminal action. 31 U.S.C. sec. 5321(b)(2).

[412] *Whistleblower 22716–13W v. Commissioner*, 146 T.C. No. 6 (March 14, 2016); and *Whistleblower 21276–13W v. Commissioner*, 147 T.C. No. 4 (August 3, 2016).

[413] *Whistleblower 22716–13W v. Commissioner*, 146 T.C. No. 6 (March 14, 2016).

[414] *Whistleblower 22716–13W v. Commissioner*, 146 T.C. No. 6 at 26–27.

[415] *Whistleblower 21276–13W v. Commissioner*, 147 T.C. No. 4 (August 3, 2016).

The money was forfeited pursuant to Title 18. The IRS argued that criminal fines and forfeitures are not collected proceeds because only amounts assessed and collected under Title 26 can be used to pay a whistleblower award. The IRS also argued that a criminal fine collected by the Government cannot be considered collected proceeds because (1) pursuant to 42 U.S.C. sec. 10601 all criminal fines collected from persons convicted of offenses against the United States are to be deposited in the Crime Victims Fund; (2) criminal fines are paid by the taxpayer directly to the imposing court, which in turn deposits them into the Crime Victims Fund; and (3) at no time are criminal fines available to the Secretary. The court said that the Code did not refer to, or require, the availability of funds to be used in making an award.[416]

Petitioners said the payment resulted from action taken by Secretary and relates to acts committed by taxpayer in violation of Title 26 provisions. The court agreed and held that collected proceeds are not limited to amounts assessed and collected under Title 26. In reaching its holding it referenced *Whistleblower 22716–13W v. Commissioner*, discussed above and noted there is no inconsistency because the issue there was about whether the threshold of $2,000,000 was exceeded. It is not clear whether FBAR penalties would be included under their holding because in the case, the taxpayer did violate Title 26 (even if the penalties were imposed under Title 18).

HOUSE BILL

No provision.

SENATE AMENDMENT

Under the provision, collected proceeds eligible for awards under the Code are defined to include: (1) penalties, interest, additions to tax, and additional amounts and (2) any proceeds under enforcement programs that the Treasury has delegated to the IRS the authority to administer, enforce, or investigate, including criminal fines and civil forfeitures, and violations of reporting requirements. This definition is also used to determine eligibility for the enhanced reward program under which proceeds and additional amounts in dispute exceed $2,000,000.

The collected proceeds amounts are determined without regard to whether such proceeds are available to the Secretary.

Effective date.—The provision is effective for information provided before, on, or after date of enactment with respect to which a final determination has not been made before such date.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

8. Exclusion from gross income of certain amounts received by wrongly incarcerated individuals (sec. 11027 of the Senate amendment and sec. 139F of the Code)

PRESENT LAW

Under a provision added in the PATH Act,[417] with respect to any wrongfully incarcerated individual, gross income does not include any civil damages, restitution, or other monetary award (including compensatory or statutory damages and restitution imposed in a criminal matter) relating to the incarceration of such individual for the covered offense for which such individual was convicted.[418]

A wrongfully incarcerated individual means an individual:

(1) who was convicted of a covered offense;

(2) who served all or part of a sentence of imprisonment relating to that covered offense; and

(3) (i) was pardoned, granted clemency, or granted amnesty for such offense because the individual was innocent, or

(ii) for whom the judgment of conviction for the offense was reversed or vacated, and whom the indictment, information, or other accusatory instrument for that covered offense was dismissed or who was found not guilty at a new trial after the judgment of conviction for that covered offense was reversed or vacated.

For these purposes, a covered offense is any criminal offense under Federal or State law, and includes any criminal offense arising from the same course of conduct as that criminal offense.

The Code contains a special rule allowing individuals to make a claim for credit or refund of any overpayment of tax resulting from the exclusion, even if such claim would be disallowed under the Code or by operation of any law or rule of law (including *res judicata*), if the claim for credit or refund is filed before the close of the one-year period beginning on the date of enactment of the PATH Act (December 18, 2015).[419]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment would extend the waiver on the statute of limitations with respect to filing a claim for a credit or refund of an overpayment of tax resulting from the exclusion described above for an additional year. Thus, under the provision, such claim for credit or refund must be filed before December 18, 2017.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

BUSINESS TAX REFORM

A. Tax Rates

1. Reduction in corporate tax rate (sec. 3001 of the House bill, secs. 13001 and 13002 of the Senate amendment, and secs. 11 and 243 of the Code)

PRESENT LAW

In general

Corporate taxable income is subject to tax under a four-step graduated rate structure.[420] 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.[421]

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.[422]

Dividends received deduction

Corporations are allowed a deduction with respect to dividends received from other taxable domestic corporations.[423] 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.[424] 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.[425]

HOUSE BILL

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.[426]

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 depreciation 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.

SENATE AMENDMENT

The Senate amendment follows the House bill, but does not provide a special rate for personal service corporations.

Effective date.—The provision applies to taxable years beginning after December 31, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, but provides for a 21-percent corporate rate effective for taxable years beginning after December 31, 2017.

In addition, for taxpayers subject to the normalization method of accounting (*e.g.*, regulated public utilities), the conference agreement clarifies the normalization of excess tax reserves resulting from the reduction of corporate income tax rates (with respect to prior depreciation or recovery allowances taken on assets placed in service before the corporate rate reduction takes effect).

The excess tax reserve is the reserve for deferred taxes as of the day before the corporate rate reduction takes effect over what

[416] *Whistleblower 21276–13W v. Commissioner*, 147 T.C. No. 4 at 28–29.

[417] Pub. L. No. 114–113 (2015), Division Q (Protecting Americans from Tax Hikes Act of 2015), sec. 304.

[418] Sec. 139F.

[419] Sec. 139F.

[420] Sec. 11(a) and (b)(1).

[421] Sec. 11(b)(2).

[422] Sec. 1201(a).

[423] 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).

[424] 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).

[425] 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).*

[426] 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.

the reserve for deferred taxes would be if the corporate rate reduction had been in effect for all prior periods. If an excess tax reserve is reduced more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method, the taxpayer will not be treated as using a normalization method with respect to the corporate rate reduction. If the taxpayer does not use a normalization method of accounting for the corporate rate reduction, 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 and the taxpayer will not be treated as using a normalization method of accounting for purposes of section 168(f)(2) and (i)(9)(C).[427]

The average rate assumption method[428] reduces the excess tax reserve over the remaining regulatory lives of the property that gave rise to the reserve for deferred taxes during the years in which the deferred tax reserve related to such property is reversing. Under this method, the excess tax reserve is reduced as the timing differences (*i.e.*, differences between tax depreciation and regulatory depreciation with respect to the property) reverse over the remaining life of the asset. The reversal of timing differences generally occurs when the amount of the tax depreciation taken with respect to an asset is less than the amount of the regulatory depreciation taken with respect to the asset. To ensure that the deferred tax reserve, including the excess tax reserve, is reduced to zero at the end of the regulatory life of the asset that generated the reserve, the amount of the timing difference which reverses during a taxable year is multiplied by the ratio of (1) the aggregate deferred taxes as of the beginning of the period in question to (2) the aggregate timing differences for the property as of the beginning of the period in question.

The following example illustrates the application of the average rate assumption method. A calendar year regulated utility placed property costing $100 million in service in 2016. For regulatory (book) purposes, the property is depreciated over 10 years on a straight line basis with a full year's allowance in the first year. For tax purposes, the property is depreciated over 5 years using the 200 percent declining balance method and a half-year placed in service convention.[429]

NORMALIZATION CALCULATION FOR CORPORATE RATE REDUCTION

(Millions of dollars—Years)

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
Tax expense	20	32	19.2	11.52	11.52	5.76	0	0	0	0	100
Book depreciation	***10***	***10***	***10***	***10***	***10***	***10***	***10***	***10***	***10***	***10***	***100***
Timing difference	10	22	9.2	1.52	1.52	(4.24)	(10)	(10)	(10)	(10)	0
Tax rate	***35%***	***35%***	***21%***	***21%***	***21%***	***31.1%***	***31.1%***	***31.1%***	***31.1%***	***31.1%***	
Annual adjustment to reserve	3.5	7.7	1.9	0.3	0.3	(1.3)	(3.1)	(3.1)	(3.1)	(3.1)	0
Cumulative deferred tax reserve	3.5	11.2	13.1	13.5	13.8	12.5	9.3	6.2	3.1	(0.0)	0
Annual adjustment at 21%						(0.9)	(2.1)	(2.1)	(2.1)	(2.1)	(9.3)
Annual adjustment at average rate						***(1.3)***	***(3.1)***	***(3.1)***	***(3.1)***	***(3.1)***	***(13.8)***
Excess tax reserve						0.4	1.0	1.0	1.0	1.0	4.5

The excess tax reserve as of December 31, 2017, the day before the corporate rate reduction takes effect, is $4.5 million.[430] The taxpayer will begin taking the excess tax reserve into account in the 2021 taxable year, which is the first year in which the tax depreciation taken with respect to the property is less than the depreciation reflected in the regulated books of account. The annual adjustment to the deferred tax reserve for the 2021 through 2025 taxable years is multiplied by 31.1 percent which is the ratio of the aggregate deferred taxes as of the beginning of 2021 ($13.8 million) to the aggregate timing differences for the property as of the beginning of 2021 ($44.2 million).

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

B. Cost Recovery

1. Increased expensing (sec. 3101 of the House bill, secs. 13201 and 13311 of the Senate amendment, 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.[431]

Tangible property

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,[432] and convention.[433]

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[434] and certain aircraft[435]).[436] 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.

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[437]
2019	30 percent	40 percent
2020	None	30 percent[438]

The additional first-year depreciation deduction is allowed for both the regular tax and the alternative minimum tax (''AMT''),[439] but is not allowed in computing earnings and profits.[440] 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.[441] The amount of the additional first-year depreciation deduction is not affected by a short taxable year.[442] The taxpayer may elect out of the additional first-year depreciation for any class of property for any taxable year.[443]

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.[444] The property's cost is $10,000, and it is five-year property

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[427] Section 168(f)(2) and (i)(9)(C) provide that if a taxpayer is required to use a normalization method of accounting with respect to public utility property and does not do so, such taxpayer must compute its depreciation allowances for Federal income tax purposes using the depreciation method, useful life determination, averaging convention, and salvage value limitation used for purposes of setting rates and reflecting operating results in its regulated books of account.

[428] See section 2.04 of Rev. Proc. 88–12, 1988–1 C.B. 637.

[429] The 5-year tax and 10-year book lives are used for illustration purposes only. In general, public utility property may be depreciated over various periods ranging from 5 to 20 years under MACRS. For regulatory purposes, public utility property may, in certain cases, have a useful life of 30 years or more.

[430] The excess tax reserve of $4.5 million is equal to the cumulative deferred tax reserve as of December 31, 2017 ($11.2 million) minus the cumulative timing difference as of December 31, 2017 ($32 million) multiplied by 21 percent.

[431] 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.

[432] 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.

[433] Sec. 168.

[434] As defined in section 168(k)(2)(B).

[435] As defined in section 168(k)(2)(C).

[436] 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.

[437] 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.

[438] 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.

[439] Sec. 168(k)(2)(G). See also Treas. Reg. sec. 1.168(k)–1(d).

[440] Sec. 312(k)(3) and Treas. Reg. sec. 1.168(k)–1(f)(7).

[441] Sec. 168(k)(1)(B).

[442] *Ibid.*

[443] Sec. 168(k)(7). For the definition of a class of property, see Treas. Reg. sec. 1.168(k)–1(e)(2).

[444] Assume that the cost of the property is not eligible for expensing under section 179 or Treas. Reg. sec. 1.263(a)–1(f).

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.[445] 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.[446] 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;[447] (3) computer software other than computer software covered by section 197; or (4) qualified improvement property.[448] Second, the original use[449] of the property must commence with the taxpayer.[450] 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.[451]

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.[452] 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.[453] 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.[454]

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.[455] Qualified improvement property does not include any improvement for which the expenditure is attributable 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.[456] 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.[457]

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.[458] 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.[459]

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.[460]

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.[461]

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).[462] 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,[463] 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.[464] 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.[465] 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.[466] 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

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[445] $1,000 results from the application of the half-year convention and the 200 percent declining balance method to the remaining $5,000.

[446] Requirements relating to actions taken before 2008 are not described herein since they have little (if any) remaining effect.

[447] As defined in section 168(e)(5).

[448] 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).

[449] 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).

[450] 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).

[451] 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-in-service 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.

[452] Sec. 168(k)(2)(E)(i).

[453] Treas. Reg. sec. 1.168(k)–1(b)(4)(iii).

[454] 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.

[455] Sec. 168(k)(3).

[456] Sec. 168(k)(4).

[457] Sec. 168(k)(4)(A)(ii).

[458] 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.

[459] Sec. 168(k)(4)(B)(iii).

[460] Sec. 168(k)(4)(D)(ii).

[461] Sec. 168(k)(4)(D)(iii).

[462] Sec. 168(k)(2)(F).

[463] Sec. 280F(d)(7).

[464] See sec. 168(k)(5).

[465] Any amount deducted under this election is not subject to capitalization under section 263A.

[466] A specified plant does not include any property that is planted or grafted outside the United States.

is determined under the percentage-of-completion method.[467] 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).[468]

Intangible property

MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording, or to any other property if the taxpayer elects to exclude such property from MACRS and the taxpayer properly applies a unit-of-production method or other method of depreciation not expressed in a term of years.[469] Section 197 (amortization of goodwill and certain other intangibles) does not apply to certain intangible property, including certain property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in a transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.[470] Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a ''stand-alone'' basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost recovery of such property may be determined under section 167, which allows a depreciation deduction for the reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property if it is used in a trade or business or held for the production of income. In addition, the costs of motion picture films, video tapes, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method of depreciation.[471]

Expensing of certain qualified film, television and live theatrical productions

Under section 181, a taxpayer may elect[472] to deduct the cost of any qualifying film, television and live theatrical production, commencing prior to January 1, 2017, in the year the expenditure is incurred in lieu of capitalizing the cost and recovering it through depreciation allowances.[473] A taxpayer may elect to deduct up to $15 million of the aggregate cost of the film or television production under this section.[474] The threshold is increased to $20 million if a significant amount of the production expenditures are incurred in areas eligible for designation as a low-income community or eligible for designation by the Delta Regional Authority as a distressed county or isolated area of distress.[475]

A qualified film, television or live theatrical production means any production of a motion picture (whether released theatrically or directly to video cassette or any other format), television program or live staged play if at least 75 percent of the total compensation expended on the production is for services performed in the United States by actors, directors, producers, and other relevant production personnel.[476] The term ''compensation'' does not include participations and residuals (as defined in section 167(g)(7)(B)).[477]

Each episode of a television series is treated as a separate production, and only the first 44 episodes of a particular series qualify under the provision.[478] Qualified productions do not include sexually explicit productions as referenced by section 2257 of title 18 of the U.S. Code.[479]

A qualified live theatrical production is defined as a live staged production of a play (with or without music) which is derived from a written book or script and is produced or presented by a commercial entity in any venue which has an audience capacity of not more than 3,000, or a series of venues the majority of which have an audience capacity of not more than 3,000.[480] In addition, qualified live theatrical productions include any live staged production which is produced or presented by a taxable entity no more than 10 weeks annually in any venue which has an audience capacity of not more than 6,500.[481] In general, in the case of multiple live-staged productions, each such live-staged production is treated as a separate production. Similar to the exclusion for sexually explicit productions from the definition of qualified film or television productions, qualified live theatrical productions do not include stage performances that would be excluded by section 2257(h)(1) of title 18 of the U.S. Code, if such provision were extended to live stage performances.[482]

For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as if it were a deduction allowable for amortization.[483]

HOUSE BILL

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.[484] 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.[485] 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.[486] Thus it does not apply, for example, if one member of an affiliated group of corporations purchases property from another member, or 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.[487]

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.[488]

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,[489] 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

[467] Sec. 460.

[468] Sec. 460(c)(6). Other dates involving prior years are not described herein.

[469] Sec. 168(f)(1), (3) and (4).

[470] Sec. 197(c)(2) and (e)(4)(A). If section 197 applies to the acquisition of intangible assets held in connection with a trade or business, any value properly attributable to a ''section 197 intangible'' is amortizable on a straight-line basis over 15 years. Sec. 197(a) and (c).

[471] Sec. 167(g)(6). Under the income forecast method, a property's depreciation deduction for a taxable year is determined by multiplying the adjusted basis of the property by a fraction, the numerator of which is the gross income generated by the property during the year, and the denominator of which is the total forecasted or estimated gross income expected to be generated prior to the close of the tenth taxable year after the year the property is placed in service. Any costs that are not recovered by the end of the tenth taxable year after the property is placed in service may be taken into account as depreciation in that year. Sec. 167(g)(1).

[472] See Treas. Reg. sec. 1.181–2 for rules on making an election under this section.

[473] For this purpose, a qualified film or television production is treated as commencing on the first date of principal photography. The date on which a qualified live theatrical production commences is the date of the first public performance of such production for a paying audience.

[474] Sec. 181(a)(2)(A). See Treas. Reg. sec. 1.181–1 for rules on determining eligible production costs.

[475] Sec. 181(a)(2)(B).

[476] Sec. 181(d)(3)(A).

[477] Sec. 181(d)(3)(B).

[478] Sec. 181(d)(2)(B).

[479] Sec. 181(d)(2)(C).

[480] Sec. 181(e)(2)(A).

[481] Sec. 181(e)(2)(D).

[482] Sec. 181(e)(2)(E).

[483] Sec. 1245(a)(2)(C).

[484] By reference to section 179(d)(2)(C). See also Treas. Reg. sec. 1.179–4(c)(1)(iv).

[485] By reference to section 179(d)(3). See also Treas. Reg. sec. 1.179–4(d).

[486] By reference to section 179(d)(2)(A) and (B). See also Treas. Reg. sec. 1.179–4(c).

[487] As defined in section 3301 of the House 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).

[488] As defined in section 3301 of the House bill (Interest).

[489] As defined in section 3301 of the House bill (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,[490] 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	None	30 percent

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[491] 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.[492]

SENATE AMENDMENT

In general

The provision extends and modifies the additional first-year depreciation deduction through 2026 (through 2027 for longer production period property and certain aircraft). The 50-percent allowance is increased to 100 percent for property 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. Thus, the provision repeals the phase-down of the 50-percent allowance for property placed in service after December 31, 2017, and for specified plants planted or grafted after such date. The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft). Under the provision, the bonus depreciation percentage rates are as follows.

Placed in Service Year[493]	Bonus Depreciation Percentage	
	Qualified Property in General	Longer Production Period Property and Certain Aircraft
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent[494]

Special rules

The provision maintains the section 280F increase amount of $8,000 for passenger automobiles placed in service after December 31, 2017.

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, 2027 (January 1, 2028, in the case of longer production period property).

Application to qualified film, television and live theatrical productions

The provision expands the definition of qualified property eligible for the additional first-year depreciation allowance to include qualified film, television and live theatrical productions[495] placed in service after September 27, 2017, and before January 1, 2027, for which a deduction otherwise would have been allowable under section 181 without regard to the dollar limitation or termination of such section. For purposes of this provision, a production is considered placed in service at the time of initial release, broadcast, or live staged performance (*i.e.*, at the time of the first commercial exhibition, broadcast, or live staged performance of a production to an audience).

Exception for certain businesses not subject to limitation on interest expense

The provision excludes from the definition of qualified property any property which is primarily used in the trade or business of the furnishing[496] 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, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.[497]

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,[498] 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 13301 of the Senate amendment by meeting the small business gross receipts test of section 448(c).

Effective date.—The provision generally applies to property placed in service after September 27, 2017, in taxable years ending after such date, 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 a 50-percent allowance instead of the 100-percent allowance.[499]

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment but also includes the House bill's removal of the requirement that the original use of qualified property must commence with the taxpayer (i.e., it allows the additional first-year depreciation deduction for new and used property).

In addition, the conference agreement also follows the House bill's application of the present-law phase-down of bonus depreciation to property acquired before September 28, 2017, and placed in service after September 27, 2017, as well as the present-law phase-down of 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. Under the conference agreement, the bonus depreciation rates are as follows.

Placed in Service Year[500]	Bonus Depreciation Percentage	
	Qualified Property in General/Specified Plants	Longer Production Period Property and Certain Aircraft
Portion of Basis of Qualified Property Acquired before Sept. 28, 2017		
Sept. 28, 2017–Dec. 31, 2017.	50 percent	50 percent
2018	40 percent	50 percent
2019	30 percent	40 percent
2020	None	30 percent[501]
2021 and thereafter	None	None
Portion of Basis of Qualified Property Acquired after Sept. 27, 2017		
Sept. 28, 2017–Dec. 31, 2022.	100 percent	100 percent
2023	80 percent	100 percent
2024	60 percent	80 percent
2025	40 percent	60 percent
2026	20 percent	40 percent
2027	None	20 percent[502]
2028 and thereafter	None	None

As a conforming amendment to the repeal of corporate AMT, the conference agreement repeals the election to accelerate AMT credits in lieu of bonus depreciation.

Effective date.—The provision generally applies to property acquired 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 a 50-percent allowance instead of the 100-percent allowance.

[490] See section 2001 of the House bill (Repeal of alternative minimum tax).

[491] Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

[492] See section 3302 of the House bill (Modification of net operating loss deduction).

[493] In the case of specified plants, this is the year of planting or grafting.

[494] Twenty percent applies to the adjusted basis attributable to manufacture, construction, or production before January 1, 2027, and the remaining adjusted basis does not qualify for bonus depreciation. Twenty percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2027.

[495] As defined in section 181(d) and (e).

[496] The term "furnishing" includes generation, transmission, and distribution activities.

[497] See sec. 13301 of the Senate amendment (Limitation on deduction for interest).

[498] As defined in section 13311 of the Senate amendment (Floor plan financing).

[499] Such election shall be made at such time and in such form and manner as prescribed by the Secretary.

[500] In the case of specified plants, this is the year of planting or grafting.

[501] Thirty 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.

[502] Twenty percent applies to the adjusted basis attributable to manufacture, construction, or production before January 1, 2027, and the remaining adjusted basis does not qualify for bonus depreciation. Twenty percent applies to the entire adjusted basis of certain aircraft described in section 168(k)(2)(C) and placed in service in 2027.

2. Modifications to depreciation limitations on luxury automobiles and personal use property (sec. 13202 of the Senate amendment and sec. 280F of the Code)

PRESENT LAW

Section 280F(a) limits the annual cost recovery deduction with respect to certain passenger automobiles. This limitation is commonly referred to as the ''luxury automobile depreciation limitation.'' For passenger automobiles placed in service in 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $3,160 for the year in which the vehicle is placed in service, $5,100 for the second year, $3,050 for the third year, and $1,875 for the fourth and later years in the recovery period.[503] This limitation is indexed for inflation and applies to the aggregate deduction provided under present law for depreciation and section 179 expensing. Hence, passenger automobiles subject to section 280F are eligible for section 179 expensing only to the extent of the applicable limits contained in section 280F. For passenger automobiles eligible for the additional first-year depreciation allowance in 2017, the first-year limitation is increased by an additional $8,000.[504]

For purposes of the depreciation limitation, passenger automobiles are defined broadly to include any four-wheeled vehicles that are manufactured primarily for use on public streets, roads, and highways and which are rated at 6,000 pounds unloaded gross vehicle weight or less.[505] In the case of a truck or a van, the depreciation limitation applies to vehicles that are rated at 6,000 pounds gross vehicle weight or less. Sport utility vehicles are treated as a truck for the purpose of applying the section 280F limitation.

Basis not recovered in the recovery period of a passenger automobile is allowable as an expense in subsequent taxable years.[506] The expensed amount is limited in each such subsequent taxable year to the amount of the limitation in the fourth year in the recovery period.

Listed property

In the case of certain listed property, special rules apply. Listed property generally is defined as (1) any passenger automobile; (2) any other property used as a means of transportation;[507] (3) any property of a type generally used for purposes of entertainment, recreation, or amusement; (4) any computer or peripheral equipment;[508] and (5) any other property of a type specified in Treasury regulations.[509]

First, if for the taxable year in which the property is placed in service, the use of the property for trade or business purposes does not exceed 50 percent of the total use of the property, then the depreciation deduction with respect to such property is determined under the alternative depreciation system.[510] The alternative depreciation system generally requires the use of the straight-line method and a recovery period equal to the class life of the property.[511] Second, if an individual owns or leases listed property that is used by the individual in connection with the performance of services as an employee, no depreciation deduction, expensing allowance, or deduction for lease payments is available with respect to such use unless the use of the property is for the convenience of the employer and required as a condition of employment.[512] Both limitations apply for purposes of section 179 expensing.

For listed property, no deduction is allowed unless the taxpayer adequately substantiates the expense and business usage of the property.[513] A taxpayer must substantiate the elements of each expenditure or use of listed property, including (1) the amount (*e.g.*, cost) of each separate expenditure and the amount of business or investment use, based on the appropriate measure (*e.g.*, mileage for automobiles), and the total use of the property for the taxable period, (2) the date of the expenditure or use, and (3) the business purposes for the expenditure or use.[514] The level of substantiation for business or investment use of listed property varies depending on the facts and circumstances. In general, the substantiation must contain sufficient information as to each element of every business or investment use.[515]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision increases the depreciation limitations under section 280F that apply to listed property. For passenger automobiles placed in service after December 31, 2017, and for which the additional first-year depreciation deduction under section 168(k) is not claimed, the maximum amount of allowable depreciation is $10,000 for the year in which the vehicle is placed in service, $16,000 for the second year, $9,600 for the third year, and $5,760 for the fourth and later years in the recovery period.[516] The limitations are indexed for inflation for passenger automobiles placed in service after 2018.

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

Effective date.—The provision is effective for property placed in service after December 31, 2017, in taxable years ending after such date.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

3. Modifications of treatment of certain farm property (sec. 13203 of the Senate amendment and sec. 168 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.[517] 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, and convention.[518]

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance.[519] The ''type of property'' of an asset is used to determine the ''class life'' of the asset, which in turn dictates the applicable recovery period for the asset.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods,[520] switching to the straight line method for the first taxable year where using the straight line method with respect to the adjusted basis as of the beginning of that year yields a larger depreciation allowance. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method is required for the aforementioned real property.

Property used in a farming business is assigned various recovery periods in the same manner as other business property. For example, depreciable assets used in agriculture activities that are assigned a recovery period of 7 years include machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agriculture, animal husbandry, and horticultural services.[521] Cotton ginning assets are also assigned a recovery period of 7 years.[522] Any single purpose agricultural or horticultural structure,[523] and any tree or vine bearing fruit or nuts are assigned a recovery period of 10 years.[524] Land

503 Rev. Proc. 2017–29, Table 3, 2017–14 I.R.B. 1065.

504 Sec. 168(k)(2)(F). For proposed changes to section 168(k), see section II.B.1. of this document (Increased expensing).

505 Sec. 280F(d)(5). Exceptions are provided for any ambulance, hearse, or combination ambulance-hearse used by the taxpayer directly in a trade or business, or any vehicle used by the taxpayer directly in the trade or business of transporting persons or property for compensation or hire.

506 Sec. 280F(a)(1)(B).

507 Property substantially all of the use of which is in a trade or business of providing transportation to unrelated persons for hire is not considered other property used as a means of transportation. Sec. 280F(d)(4)(C).

508 Computer or peripheral equipment used exclusively at a regular business establishment and owned or leased by the person operating such establishment, however, is not listed property. Sec. 280F(d)(4)(B).

509 Sec. 280F(d)(4)(A).

510 Sec. 280F(b)(1). If for any taxable year after the year in which the property is placed in service the use of the property for trade or business purposes decreases to 50 percent or less of the total use of the property, then the amount of depreciation allowed in prior years in excess of the amount of depreciation that would have been allowed for such prior years under the alternative depreciation system is recaptured (*i.e.*, included in gross income) for such taxable year.

511 Sec. 168(g).

512 Sec. 280F(d)(3).

513 Sec. 274(d)(4).

514 Temp. Reg. sec. 1.274–5T(b)(6).

515 Temp. Reg. sec. 1.274–5T(c)(2)(ii)(C).

516 Rev. Proc. 2017–29, Table 3, 2017–14 I.R.B. 1065.

517 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.

518 Sec. 168.

519 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.

520 Under the declining balance method the depreciation rate is determined by dividing the appropriate percentage (here 150 or 200) by the appropriate recovery period. This leads to accelerated depreciation when the declining balance percentage is greater than 100. The table below illustrates depreciation for an asset with a cost of $1,000 and a seven-year recovery period under the 200-percent declining balance method, the 150-percent declining balance method, and the straight line method. **(see endnote at end of table)**

521 Rev. Proc. 87–56, Asset class 01.1, Agriculture.

522 Rev. Proc. 87–56, Asset class 01.11, Cotton ginning assets.

523 Within the meaning of section 168(i)(13). See also Rev. Proc. 87–56, Asset class 01.4, Single purpose agricultural or horticultural structures. Farm buildings that do not meet the definition of a single purpose agricultural or horticultural structure are assigned a recovery period of 20 years. Rev. Proc. 87–56, Asset class 01.3, Farm buildings except structures included in asset class 01.4.

524 Sec. 168(e)(3)(D)(i) and (ii).

improvements such as drainage facilities, paved lots, and water wells are assigned a recovery period of 15 years.[525]

A 5-year recovery period was assigned to new farm machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which was used in a farming business,[526] the original use of which commenced with the taxpayer after December 31, 2008, and which was placed in service before January 1, 2010.[527]

Any property (other than nonresidential real property,[528] residential rental property,[529] and trees or vines bearing fruits or nuts[530]) used in a farming business[531] is subject to the 150-percent declining balance method.[532]

Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures are required to depreciate all farming assets using the alternative depreciation system (*i.e.*, using longer recovery periods and the straight line method).[533]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision shortens the recovery period from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business, the original use of which commences with the taxpayer and is placed in service after December 31, 2017.

The provision also repeals the required use of the 150-percent declining balance method for property used in a farming business (*i.e.*, for 3-, 5-, 7-, and 10-year property). The 150-percent declining balance method will continue to apply to any 15-year or 20-year property used in the farming business to which the straight line method does not apply, or to property for which the taxpayer elects the use of the 150-percent declining balance method.

For these purposes, the term ''farming business'' means a farming business as defined in section 263A(e)(4). Thus, the term ''farming business'' means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity (*e.g.*, the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals).[534] A farming business includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products.[535] A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another taxpayer, or merely buying and reselling plants or animals grown or raised by another taxpayer.[536]

Effective date.—The provision is effective for property placed in service after December 31, 2017, in taxable years ending after such date.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

4. Applicable recovery period for real property (sec. 13204 of the Senate amendment and sec. 168 of the Code)

PRESENT LAW

In general

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.[537] 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, and convention.[538]

Recovery periods and depreciation methods

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance.[539] The ''type of property'' of an asset is used to determine the ''class life'' of the asset, which in turn dictates the applicable recovery period for the asset.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods,[540] switching to the straight line method for the first taxable year where using the straight line method with respect to the adjusted basis as of the beginning of that year yields a larger depreciation allowance. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property. The straight line depreciation method is required for the aforementioned real property.

Placed-in-service conventions

Depreciation of an asset begins when the asset is deemed to be placed in service under the applicable convention.[541] Under MACRS, nonresidential real property, residential rental property, and any railroad grading or tunnel bore generally are subject to the mid-month convention, which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.[542] All other property generally is subject to the half-year convention, which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year to reflect the assumption that assets are placed in service ratably throughout the year.[543] However, if substantial property is placed in service during the last three months of a taxable year, a special rule requires use of the mid-quarter convention,[544] designed to prevent the recognition of disproportionately large amounts of first-year depreciation under the half-year convention.

Depreciation of additions or improvements to property

The recovery period for any addition or improvement to real or personal property begins on the later of (1) the date on which the addition or improvement is placed in service, or (2) the date on which the property with respect to which such addition or improvement is made is placed in service.[545] Any MACRS deduction for an addition or improvement to any property is to be computed in the same manner as the deduction for the underlying property would be if such property were placed in service at the same time as such addition or improvement. Thus, for example, the cost of an improvement to a building that constitutes nonresidential real property is recovered over 39 years using the straight line method and mid-month convention. Certain improvements to nonresidential real property are eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met (*i.e.*, improvements that constitute ''qualified improvement property'').[546]

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.[547] Qualified improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, or the internal structural framework of the building.

Depreciation of leasehold improvements

Generally, depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease.[548] This rule applies regardless of whether the lessor or the lessee places the leasehold improvements in service. If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement generally is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service. However, exceptions to the 39-year recovery period exist for certain qualified leasehold improvements, qualified restaurant property, and qualified retail improvement property.

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[525] Rev. Proc. 87–56, Asset class 00.3, Land improvements. See also, IRS Publication 225, Farmer's Tax Guide (2017).

[526] As defined in section 263A(e)(4). See also Treas. Reg. sec. 1.263A–4(a)(4).

[527] Sec. 168(e)(3)(B)(vii).

[528] Sec. 168(b)(3)(A).

[529] Sec. 168(b)(3)(B).

[530] Sec. 168(b)(3)(E).

[531] Within the meaning of section 263A(e)(4). *See also* Treas. Reg. sec. 1.263A–4(a)(4).

[532] Sec. 168(b)(2)(B).

[533] Sec. 263A(d)(3) and (e)(2)

[534] Treas. Reg. sec. 1.263A–4(a)(4)(i).

[535] Treas. Reg. sec. 1.263A–4(a)(4)(ii).

[536] Treas. Reg. sec. 1.263A–4(a)(4)(i).

[537] 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.

[538] Sec. 168.

[539] 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.

[540] Under the declining balance method the depreciation rate is determined by dividing the appropriate percentage (here 150 or 200) by the appropriate recovery period. This leads to accelerated depreciation when the declining balance percentage is greater than 100. The table below illustrates depreciation for an asset with a cost of $1,000 and a seven-year recovery period under the 200-percent declining balance method, the 150-percent declining balance method, and the straight line method. **(see endnote for table)**

[541] Treas. Reg. sec. 1.167(a)–10(b).

[542] Sec. 168(d)(2) and (d)(4)(B).

[543] Sec. 168(d)(1) and (d)(4)(A).

[544] The mid-quarter convention treats all property placed in service (or disposed of) during any quarter as placed in service (or disposed of) on the mid-point of such quarter. Sec. 168(d)(3) and (d)(4)(C).

[545] Sec. 168(i)(6).

[546] Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See also section 13201 of the bill (Temporary 100-percent expensing for certain business assets).

[547] Sec. 168(k)(3).

[548] Sec. 168(i)(8).

Qualified leasehold improvement property

Section 168(e)(3)(E)(iv) provides a statutory 15-year recovery period for qualified leasehold improvement property. Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met.[549] The improvement must be made under or pursuant to a lease either by the lessee (or sublessee), or by the lessor, of that portion of the building to be occupied exclusively by the lessee (or sublessee). The improvement must be placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building. If a lessor makes an improvement that qualifies as qualified leasehold improvement property, such improvement does not qualify as qualified leasehold improvement property to any subsequent owner of such improvement. An exception to the rule applies in the case of death and certain transfers of property that qualify for non-recognition treatment.

Qualified leasehold improvement property is generally recovered using the straight-line method and a half-year convention,[550] and is eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met.[551]

Qualified restaurant property

Section 168(e)(3)(E)(v) provides a statutory 15-year recovery period for qualified restaurant property. Qualified restaurant property is any section 1250 property that is a building or an improvement to a building, if more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.[552] Qualified restaurant property is recovered using the straight-line method and a half-year convention.[553] Additionally, qualified restaurant property is not eligible for the additional first-year depreciation deduction unless it also satisfies the definition of qualified improvement property.[554]

Qualified retail improvement property

Section 168(e)(3)(E)(ix) provides a statutory 15-year recovery period for qualified retail improvement property. Qualified retail improvement property is any improvement to an interior portion of a building which is nonresidential real property if such portion is open to the general public[555] and is used in the retail trade or business of selling tangible personal property to the general public, and such improvement is placed in service more than three years after the date the building was first placed in service.[556] Qualified retail improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.[557] In the case of an improvement made by the owner of such improvement, the improvement is a qualified retail improvement only so long as the improvement is held by such owner.[558]

Retail establishments that qualify for the 15-year recovery period include those primarily engaged in the sale of goods. Examples of these retail establishments include, but are not limited to, grocery stores, clothing stores, hardware stores, and convenience stores. Establishments primarily engaged in providing services, such as professional services, financial services, personal services, health services, and entertainment, do not qualify. Generally, it is intended that businesses defined as a store retailer under the current North American Industry Classification System (industry sub-sectors 441 through 453) qualify while those in other industry classes do not qualify.[559]

Qualified retail improvement property is recovered using the straight-line method and a half-year convention,[560] and is eligible for the additional first-year depreciation deduction if the other requirements of section 168(k) are met.[561]

Alternative depreciation system

The alternative depreciation system (''ADS'') is required to be used for tangible property used predominantly outside the United States, certain tax-exempt use property, tax-exempt bond financed property, and certain imported property covered by an Executive order.[562] An election to use ADS is available to taxpayers for any class of property for any taxable year.[563] Under ADS, all property is depreciated using the straight line method over recovery periods which generally are equal to the class life of the property, with certain exceptions.[564] For example nonresidential real and residential rental property have a 40-year ADS recovery period, while qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property have a 39-year ADS recovery period.[565]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision shortens the recovery period for determining the depreciation deduction with respect to nonresidential real and residential rental property to 25 years. As a conforming amendment, the provision changes the statutory recovery period for nonresidential real and residential rental property to 25 years for purposes of determining whether a rental agreement is a long-term agreement under the section 467 rules applicable to certain payments for the use of property or services.[566] The provision also shortens the ADS recovery period for residential rental property from 40 years to 30 years.

The provision eliminates the separate definitions of qualified leasehold improvement, qualified restaurant, and qualified retail improvement property, and provides a general 10-year recovery period for qualified improvement property,[567] and a 20-year ADS recovery period for such property. Thus, for example, qualified improvement property placed in service after December 31, 2017, is generally depreciable over 10 years using the straight line method and half-year convention, without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after December 31, 2017, that does not meet the definition of qualified improvement property is depreciable over 25 years as nonresidential real property, using the straight line method and the mid-month convention.

As a conforming amendment, the provision replaces the references in section 179(f) to qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property with a reference to qualified improvement property.[568] Thus, for example, the provision allows section 179 expensing for improvement property without regard to whether the improvements are property subject to a lease, placed in service more than three years after the date the building was first placed in service, or made to a restaurant building. Restaurant building property placed in service after December 31, 2017, that does not meet the definition of qualified improvement property is not eligible for section 179 expensing.

The provision also requires a real property trade or business[569] electing out of the limitation on the deduction for interest to use ADS to depreciate any of its nonresidential real property, residential rental property, and qualified improvement property.

Effective date.—The provision is effective for property placed in service after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment except that it maintains the present law general MACRS recovery periods of 39 and 27.5 years for nonresidential real and residential rental property, respectively. In addition, the conference agreement provides a general 15-year MACRS recovery period for qualified improvement property.

5. Use of alternative depreciation system for electing farming businesses (sec. 13205 of the Senate amendment and sec. 168 of the Code)

PRESENT LAW

In general

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.[570] 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, and convention.[571]

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[549] Sec. 168(e)(6).

[550] Sec. 168(b)(3)(G) and (d).

[551] Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See section 13201 of the bill (Temporary 100-percent expensing for certain business assets).

[552] Sec. 168(e)(7).

[553] Sec. 168(b)(3)(H) and (d).

[554] Sec. 168(e)(7)(B).

[555] Improvements to portions of a building not open to the general public (*e.g.*, stock room in back of retail space) do not qualify under the provision.

[556] Sec. 168(e)(8).

[557] Sec. 168(e)(8)(C).

[558] Sec. 168(e)(8)(B). Rules similar to section 168(e)(6)(B) apply in the case of death and certain transfers of property that qualify for non-recognition treatment.

[559] Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 110th Congress* (JCS–1–09), March 2009, p. 402.

[560] Sec. 168(b)(3)(I) and (d).

[561] Sec. 168(k)(2)(A)(i)(IV) and (k)(3). See section 13301 of the bill (Temporary 100-percent expensing for certain business assets).

[562] Sec. 168(g).

[563] Sec. 168(g)(7).

[564] Sec. 168(g)(2) and (3).

[565] Sec. 168(g)(3).

[566] A long-term section 467 rental agreement is a lease of property for a term in excess of 75 percent of the property's statutory recovery period. Sec. 467(b)(4)(A) and (e)(3)(A). A disqualified long-term agreement is one that has as one of its principal purposes the avoidance of taxes. Sec. 467(b)(4)(B).

[567] Described in present law section 168(k)(3).

[568] For additional changes to section 179, see section 13101 of the Senate amendment (Modifications of rules for expensing depreciable business assets).

[569] As defined in section 13301 of the Senate amendment (Limitation on deduction for interest), by cross reference to section 469(c)(7)(C) (i.e., any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business). 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).

[570] 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.

[571] Sec. 168.

The applicable recovery period for an asset is determined in part by statute and in part by historic Treasury guidance.[572] The ''type of property'' of an asset is used to determine the ''class life'' of the asset, which in turn dictates the applicable recovery period for the asset.

The MACRS recovery periods applicable to most tangible personal property range from three to 20 years. The depreciation methods generally applicable to tangible personal property are the 200-percent and 150-percent declining balance methods,[573] switching to the straight line method for the first taxable year where using the straight line method with respect to the adjusted basis as of the beginning of that year yields a larger depreciation allowance. The recovery periods for most real property are 39 years for nonresidential real property and 27.5 years for residential rental property.[574] The straight line depreciation method is required for the aforementioned real property.

Property used in a farming business is assigned various recovery periods in the same manner as other business property. For example, depreciable assets used in agriculture activities that are assigned a recovery period of 7 years include machinery and equipment, grain bins, and fences (but no other land improvements), that are used in the production of crops or plants, vines, and trees; livestock; the operation of farm dairies, nurseries, greenhouses, sod farms, mushrooms cellars, cranberry bogs, apiaries, and fur farms; and the performance of agriculture, animal husbandry, and horticultural services.[575] Cotton ginning assets are also assigned a recovery period of 7 years.[576] Any single purpose agricultural or horticultural structure,[577] and any tree or vine bearing fruit or nuts are assigned a recovery period of 10 years.[578] Land improvements such as drainage facilities, paved lots, and water wells are assigned a recovery period of 15 years.[579]

A 5-year recovery period was assigned to new farm machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which was used in a farming business,[580] the original use of which commenced with the taxpayer after December 31, 2008, and which was placed in service before January 1, 2010.[581]

Any property (other than nonresidential real property,[582] residential rental property,[583] and trees or vines bearing fruits or nuts[584]) used in a farming business[585] is subject to the 150-percent declining balance method.[586]

Alternative depreciation system

The alternative depreciation system (''ADS'') is required to be used for tangible property used predominantly outside the United States, certain tax-exempt use property, tax-exempt bond financed property, and certain imported property covered by an Executive order.[587] An election to use ADS is available to taxpayers for any class of property for any taxable year.[588] Under ADS, all property is depreciated using the straight line method over recovery periods which generally are equal to the class life of the property, with certain exceptions.[589] For example, any single purpose agricultural or horticultural structure has a 15-year ADS recovery period,[590] while any tree or vine bearing fruit or nuts has a 20-year ADS recovery period.[591] Similarly, land improvements such as drainage facilities, paved lots, and water wells have an ADS recovery period of 20 years.[592]

Under a special accounting rule, certain taxpayers engaged in the business of farming who elect to deduct preproductive period expenditures under the uniform capitalization rules are required to depreciate all farming assets using ADS.[593]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision requires an electing farming business,[594] i.e., a farming business electing out of the limitation on the deduction for interest,[595] to use ADS to depreciate any property with a recovery period of 10 years or more (e.g., property such as single purpose agricultural or horticultural structures, trees or vines bearing fruit or nuts, farm buildings, and certain land improvements).

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Expensing of certain costs of replanting citrus plants lost by reason of casualty (sec. 13207 of the Senate amendment and sec. 263A of the Code)

PRESENT LAW

In general

The uniform capitalization (''UNICAP'') rules, which were enacted as part of the Tax Reform Act of 1986,[596] require certain direct and indirect costs allocable to real or tangible personal property produced by the taxpayer to be either capitalized into the basis of such property or included in inventory, as applicable.[597] 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 either capitalized into the basis of such property or included in inventory, as applicable.

Section 263A generally requires the capitalization of the direct and indirect costs allocable to the production of any property in a farming business, including animals and plants without regard to the length of their preproductive period.[598] The costs of a plant generally required to be capitalized under section 263(a) include preparatory costs incurred so that the plant's growing process may begin, such as the acquisition costs of the seed, seedling, or plant. Under section 263A, the costs of producing a plant generally required to be capitalized also include the preproductive period costs of planting, cultivating, maintaining, and developing the plant during the preproductive period.[599] Preproductive period costs may include management, irrigation, pruning, soil and water conservation, fertilizing, frost protection, spraying, harvesting, storage and handling, upkeep, electricity, tax depreciation and repairs on buildings and equipment used in raising the plants, farm overhead, taxes, and interest, as applicable.[600]

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572 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.

573 Under the declining balance method the depreciation rate is determined by dividing the appropriate percentage (here 150 or 200) by the appropriate recovery period. This leads to accelerated depreciation when the declining balance percentage is greater than 100. The table below illustrates depreciation for an asset with a cost of $1,000 and a seven-year recovery period under the 200-percent declining balance method, the 150-percent declining balance method, and the straight line method.

574 However, section 13204 of the bill (Applicable recovery period for real property) reduces the recovery period to 25 years for both nonresidential real property and residential rental property. **(see endnote for table)**

575 Rev. Proc. 87–56, Asset class 01.1, Agriculture.

576 Rev. Proc. 87–56, Asset class 01.11, Cotton ginning assets.

577 Within the meaning of section 168(i)(13). See also Rev. Proc. 87–56, Asset class 01.4, Single purpose agricultural or horticultural structures. Farm buildings that do not meet the definition of a single purpose agricultural or horticultural structure are assigned a recovery period of 20 years. Rev. Proc. 87–56, Asset class 01.3, Farm buildings except structures included in asset class 01.4.

578 Sec. 168(e)(3)(D)(i) and (ii).

579 Rev. Proc. 87–56, Asset class 00.3, Land improvements. See also, IRS Publication 225, Farmer's Tax Guide (2017).

580 As defined in section 263A(e)(4).

581 Sec. 168(e)(3)(B)(vii). However, section 13203 of the bill (Modifications of treatment of certain farm property) also shortens the recovery period from 7 to 5 years for any machinery or equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) which is used in a farming business, the original use of which commences with the taxpayer and is placed in service after December 31, 2017.

582 Sec. 168(b)(3)(A).

583 Sec. 168(b)(3)(B).

584 Sec. 168(b)(3)(E).

585 Within the meaning of section 263A(e)(4).

586 Sec. 168(b)(2)(B). However, section 13203 of the bill (Modifications of treatment of certain farm property) repeals the required use of the 150-percent declining balance method for property used in a farming business (i.e., for 3-, 5-, 7-, and 10-year property). The 150-percent declining balance method will continue to apply to any 15-year or 20-year property used in the farming business to which the straight line method does not apply, or to property for which the taxpayer elects the use of the 150-percent declining balance method.

587 Sec. 168(g).

588 Sec. 168(g)(7).

589 Sec. 168(g)(2) and (3).

590 Sec. 168(g)(3)(B). Farm buildings that do not meet the definition of a single purpose agricultural or horticultural structure have an ADS recovery period of 25 years. Rev. Proc. 87–56, Asset class 01.3, Farm buildings except structures included in asset class 01.4.

591 Sec. 168(g)(3)(B).

592 Rev. Proc. 87–56, Asset class 00.3, Land improvements.

593 Sec. 263A(d)(3) and (e)(2).

594 As defined in section 13301 of the Senate amendment (Limitation on deduction for interest), by cross reference to section 263A(e)(4) (i.e., farming business means the trade or business of farming and includes the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots)). Treas. Reg. sec. 1.263A–4(a)(4) further defines a farming business as a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. Examples of a farming business include the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals. A farming business also includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products. See Treas. Reg. sec. 1.263A–4(a)(4)(i) and (ii). A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another taxpayer, or merely buying and reselling plants or animals grown or raised by another taxpayer. See Treas. Reg. sec. 1.263A–4(a)(4)(i).

595 See section 13301 of the Senate amendment (Limitation on deduction for interest). Section 13301 of the Senate amendment also includes an exception from the limitation on the deduction for interest for taxpayers meeting the $15 million gross receipts test.

596 Sec. 803(a) of Pub. L. No. 99–514 (1986).

597 Sec. 263A.

598 Treas. Reg. sec. 1.263A–4(b)(1).

599 Treas. Reg. sec. 1.263A–4(b)(1)(i).

600 Ibid.

Special rules for plant farmers

Section 263A provides an exception to the general capitalization requirements for taxpayers who raise, harvest, or grow trees.[601] 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 UNICAP rules do not apply to any plant having a preproductive period of two years or less, 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)).[602] Hence, in general, the UNICAP rules apply to the production of plants that have a preproductive period of more than two years, and to taxpayers required to use an accrual method of accounting.

Plant farmers otherwise required to capitalize preproductive period costs may elect to deduct such costs currently, provided the alternative depreciation system described in section 168(g)(2) is used on all farm assets and the preproductive period costs are recaptured upon disposition of the product.[603] The election is not available to taxpayers required to use the accrual method of accounting. Moreover, the election is not available with respect to certain costs attributable to planting, cultivating, maintaining, or developing citrus or almond groves.

Section 263A does not apply to costs incurred in replanting edible crops for human consumption following loss or damage due to freezing temperatures, disease, drought, pests, or casualty.[604] The same type of crop as the lost or damaged crop must be replanted. However, the exception to capitalization still applies if the replanting occurs on a parcel of land other than the land on which the damage occurred provided the acreage of the new land does not exceed that of the land to which the damage occurred and the new land is located in the United States. This exception may also apply to costs incurred by persons other than the taxpayer who incurred the loss or damage, provided (1) the taxpayer who incurred the loss or damage retains an equity interest of more than 50 percent in the property on which the loss or damage occurred at all times during the taxable year in which the replanting costs are paid or incurred, and (2) the person holding a minority equity interest and claiming the deduction materially participates in the planting, maintenance, cultivation, or development of the property during the taxable year in which the replanting costs are paid or incurred.[605]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision modifies the special rule for costs incurred by persons other than the taxpayer in connection with replanting an edible crop for human consumption following loss or damage due to casualty. Under the provision, with respect to replanting costs paid or incurred after the date of enactment, but no later than a date which is ten years after such date of enactment, for citrus plants lost or damaged due to casualty, such replanting costs may also be deducted by a person other than the taxpayer if (1) the taxpayer has an equity interest of not less than 50 percent in the replanted citrus plants at all times during the taxable year in which the replanting costs are paid or incurred and such other person holds any part of the remaining equity interest, or (2) such other person acquires all of the taxpayer's equity interest in the land on which the lost or damaged citrus plants were located at the time of such loss or damage, and the replanting is on such land.

Effective date.—The provision is effective for costs paid or incurred after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

C. Small Business Reforms

1. Expansion of section 179 expensing (sec. 3201 of the House bill, sec. 13101 of the Senate amendment, 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.[606] 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,[607] and convention.[608]

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.[609] The $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.[610] The $500,000 and $2,000,000 amounts are indexed for inflation for taxable years beginning after 2015.[611]

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. 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).[612] Qualifying property excludes any property described in section 50(b) (*i.e.*, certain property not eligible for the investment tax credit).[613]

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 and not more than the 14,000 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 (the ''sport utility vehicle limitation'').[614]

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).[615] 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.[616] 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.[617]

An expensing election is made under rules prescribed by the Secretary.[618] 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.

HOUSE BILL

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

[601] Sec. 263A(c)(5).

[602] Sec. 263A(d).

[603] Sec. 263A(d)(3), (e)(1), and (e)(2).

[604] Sec. 263A(d)(2). Such replanting costs generally include costs attributable to the replanting, cultivating, maintaining, and developing of the plants that were lost or damaged that are incurred during the preproductive period. Treas. Reg. sec. 1.263A–4(e)(1). The acquisition costs of the replacement trees or seedlings must still be capitalized under section 263(a) (see, *e.g.*, T.D. 8897, 65 FR 50638, Treas. Reg. sec. 1.263A–4(e)(3), Examples 1–3, and TAM 9547002 (July 18, 1995)), potentially subject to the special bonus depreciation deduction in the year of planting under section 168(k)(5).

[605] Sec. 263A(d)(2)(B). Material participation for this purpose is determined in a similar manner as under section 2032A(e)(6) (relating to qualified use valuation of farm property upon death of the taxpayer).

[606] 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.

[607] 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.

[608] Sec. 168.

[609] Sec. 179(b)(1).

[610] Sec. 179(b)(2).

[611] Sec. 179(b)(6).

[612] Sec. 179(d)(1)(A)(ii) and (f).

[613] Sec. 179(d)(1) flush language. Property described in section 50(b) is generally property used outside the United States, certain property used for lodging, property used by certain tax exempt organizations, and property used by governmental units and foreign persons or entities.

[614] Sec. 179(b)(5). For this purpose, a sport utility vehicle is defined to exclude any vehicle that: (1) is designed for more than nine individuals in seating rearward of the driver's seat; (2) is equipped with an open cargo area, or a covered box not readily accessible from the passenger compartment, of at least six feet in interior length; or (3) has an integral enclosure, fully enclosing the driver compartment and load carrying device, does not have seating rearward of the driver's seat, and has no body section protruding more than 30 inches ahead of the leading edge of the windshield.

[615] Sec. 179(b)(3).

[616] Sec. 179(d)(9).

[617] Sec. 312(k)(3)(B).

[618] Sec. 179(c)(1).

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[619] and placed in service after November 2, 2017.

SENATE AMENDMENT

The provision increases the maximum amount a taxpayer may expense under section 179 to $1,000,000, and increases the phase-out threshold amount to $2,500,000. Thus, the provision provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2017, is $1,000,000 of the cost of qualifying property placed in service for the taxable year. The $1,000,000 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 $2,500,000. The $1,000,000 and $2,500,000 amounts, as well as the $25,000 sport utility vehicle limitation, are indexed for inflation for taxable years beginning after 2018.

The provision expands the definition of section 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging.[620]

The provision also expands the definition of qualified real property eligible for section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

Effective date.—The provision applies to property placed in service in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

2. Small business accounting method reform and simplification (sec. 3202 of the House bill, secs. 13102 through 13105 of the Senate amendment, 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.[621] Permissible overall methods of accounting include 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.[622] Examples of any one item for which an accounting method may be adopted include cost recovery,[623] revenue recognition,[624] and timing of deductions.[625] For each separate trade or business, a taxpayer is entitled to adopt any permissible method, subject to certain restrictions.[626]

A taxpayer filing its first return may adopt any permissible method of accounting in computing taxable income for such year.[627] 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.[628]

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.[629] 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.[630] 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.[631] In addition, the cash method generally may not be used if the purchase, production, or sale of merchandise is an income producing factor.[632] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[633]

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.[634] 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.[635] 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.[636] 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.[637] However, an exception is provided for taxpayers whose average annual gross receipts do not exceed $1 million.[638] 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.[639] Such taxpayers may account for inventory as materials and supplies that are not incidental (*i.e.*, ''non-incidental materials and supplies'').[640]

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

[619] Property is not treated as acquired after the date on which a written binding contract is entered into for such acquisition.

[620] As defined in section 50(b)(2). Property used predominantly to furnish lodging or in connection with furnishing lodging generally includes, *e.g.*, beds and other furniture, refrigerators, ranges, and other equipment used in the living quarters of a lodging facility such as an apartment house, dormitory, or any other facility (or part of a facility) where sleeping accommodations are provided and let. See Treas. Reg. sec. 1.48–1(h).

[621] Treas. Reg. sec. 1.446–1(a)(1).

[622] Sec. 446(c).

[623] See, *e.g.*, secs. 167 and 168.

[624] See, *e.g.*, secs. 451 and 460.

[625] See, *e.g.*, secs. 461 and 467.

[626] Sec. 446(d); Treas. Reg. sec. 1.446–1(d).

[627] Treas. Reg. sec. 1.446–1(e)(1).

[628] Treas. Reg. sec. 1.446–1(e).

[629] See, *e.g.*, sec. 451.

[630] See, *e.g.*, sec. 461.

[631] 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 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.

[632] Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1.

[633] Sec. 471 and Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1.

[634] Sec. 448(d)(1).

[635] Sec. 448(d)(2).

[636] Sec. 471(a) and Treas. Reg. sec. 1.471–1.

[637] Treas. Reg. sec. 1.446–1(c)(2).

[638] Rev. Proc. 2001–10, 2001–1 C.B. 272.

[639] Rev. Proc. 2002–28, 2002–1 C.B. 815.

[640] 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.

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.[641] 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;[642] such taxpayers are not required to include additional section 263A costs in inventory. Another exception exists for taxpayers who raise, harvest, or grow trees.[643] 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)).[644] Freelance authors, photographers, and artists also are exempt from section 263A for any qualified creative expenses.[645]

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.[646] Under this method, the taxpayer must include in gross income for the taxable year an amount equal to the product of (1) the gross contract price and (2) the percentage of the contract completed during the taxable year.[647] 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.[648] 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.[649] The allocation of costs to a contract is made in accordance with regulations.[650] 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.[651]

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.[652] Thus, long-term contract income from small construction contracts must be reported consistently using the taxpayer's exempt contract method.[653] 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.[654]

HOUSE BILL

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.[655]

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 for inventories under section 471[656], but rather may use a method of accounting for inventories that either (1) treats inventories as non-incidental materials and supplies[657], or (2) conforms to the taxpayer's financial accounting treatment of inventories.[658]

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.[659] 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.[660]

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.

Application of the provisions to expand the universe of taxpayers eligible to use the cash method, exempt certain taxpayers from the requirement to keep inventories, and expand the exception from the uniform capitalization rules 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).

Effective date.—The provisions to expand the universe of taxpayers 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. 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.

[641] Sec. 263A.

[642] 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).

[643] Sec. 263A(c)(5).

[644] Sec. 263A(d).

[645] 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.

[646] Sec. 460(a).

[647] 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.

[648] Sec. 460(b)(1).

[649] Sec. 460(c).

[650] Treas. Reg. sec. 1.460–5.

[651] Treas. Reg. secs. 1.460–4(b)(2)(iv) and 1.460–1(b)(8).

[652] Secs. 460(e)(1)(B) and (4).

[653] 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.

[654] Treas. Reg. sec. 1.460–4(c)(1).

[655] 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.

[656] 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.

[657] 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).

[658] 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 House 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.

[659] 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.

[660] 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill with the following modifications. The Senate amendment modifies the $25 million gross receipts test to be a $15 million gross receipts test which is met if a taxpayer's annual average gross receipts do not exceed $15 million for the three prior taxable-year period. The Senate amendment retains the present law $25 million gross receipts limit for family farming corporations and applies such limit consistent with present law.

Effective date.—The provisions to expand the universe of taxpayers 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. 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.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

3. Modification of treatment of S corporation conversions to C corporations (sec. 3204 of the House bill, sec. 13543 of the Senate amendment, 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.[661] 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.[662] 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,[663] qualified personal service corporations,[664] 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").[665] The cash method may not be used by any tax shelter.[666] In addition, the cash method generally may not be used if the purchase, production, or sale of merchandise is an income producing factor.[667] Such taxpayers generally are required to keep inventories and use an accrual method with respect to inventory items.[668]

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.[669] 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.[670]

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.[671] 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.[672] 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.[673] 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.[674]

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 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.[675] The post-termination transition period is generally the one-year period after the S corporation election terminates.[676]

HOUSE BILL

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.[677] 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.

SENATE AMENDMENT

The Senate amendment generally is the same as the House bill, except that any increase in tax due to the section 481(a) adjustment, rather than the section 481(a) adjustment itself, is taken into account ratably during the six-taxable-year period beginning with the year of change.

Effective date.—The provision is effective for distributions after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

D. Reform of Business Related Exclusions, Deductions, etc.

1. Interest (secs. 3203 and 3301 of the House bill, secs. 13301 and 13311 of the Senate amendment, 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

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[661] See, *e.g.*, sec. 451.

[662] See, *e.g.*, sec. 461.

[663] 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).

[664] 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).

[665] 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).

[666] 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 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.

[667] Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1.

[668] Sec. 471 and Treas. Reg. secs. 1.446–1(c)(2) and 1.471–1. However, section 3202 of the House 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.

[669] Treas. Reg. sec. 1.446–1(e)(1).

[670] Treas. Reg. sec. 1.446–1(e).

[671] Sec. 481(a)(2) and Treas. Reg. sec. 1.481–1(a)(1).

[672] Treas. Reg. sec. 1.481–1(a)(1).

[673] 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).

[674] See Section 7.03 of Rev. Proc. 2015–13, 2015–5 I.R.B 419.

[675] Sec. 1371(e)(1).

[676] Sec. 1377(b).

[677] Section 3202 of the House 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.

taxable income subject to a number of limitations.[678]

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.[679] 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.[680] 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.

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'').[681] Miscellaneous itemized deductions[682] that are not investment expenses are disallowed first before any investment expenses are disallowed.[683]

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;[684] (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.[685] Interest amounts disallowed under these rules can be carried forward indefinitely.[686] 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.[687]

HOUSE BILL

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).[688]

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 amount of any net operating loss deduction; and (4) any deduction allowable for depreciation, amortization, or depletion.[689] 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.[690] 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 additional 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

[678] 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).

[679] Sec. 163(e). But see section 267 (dealing in part with interest paid to a related or foreign party).

[680] Sec. 163(d).

[681] Sec. 67(a).

[682] 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.

[683] 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.'').

[684] 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).

[685] Sec. 163(j)(3).

[686] Sec. 163(j)(1)(B).

[687] Sec. 163(j)(2)(B)(ii).

[688] 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.

[689] Any deduction allowable for depreciation, amortization, or depletion includes any deduction allowable for any amount treated as depreciation, amortization, or depletion under present law.

[690] 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).

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.[691] 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.[692] 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.

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[693] 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. 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.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications.

In general

The Senate amendment makes several changes to the definition of adjusted taxable income. Specifically, the Senate amendment does not add back deductions allowable for depreciation, amortization, or depletion, but does add back any deduction under section 199,[694] and any deduction under section 199A with respect to qualified business income of a passthrough entity.[695]

The Senate amendment also modifies the definition of floor plan financing. Specifically, the Senate amendment permits interest on indebtedness used to finance acquisition of motor vehicles for sale or lease (*i.e.*, not just for sale, as in the House bill) to qualify as floor plan financing interest. The Senate amendment also includes self-propelled vehicles in the definition of motor vehicle, but removes construction machinery and equipment from the definition.

Carryforward of disallowed business interest

The Senate amendment permits interest deductions to be carried forward indefinitely, subject to certain restrictions applicable to partnerships, described below.

Application to passthrough entities

The Senate amendment requires a partner in a partnership to ignore the partner's distributive share of all items of income, gain, deduction, or loss of the partnership when calculating adjusted taxable income (rather than merely ignoring the nonseparately stated income or loss, as in the House bill).

The Senate amendment takes a different mathematical approach from the House bill to calculating a partner's interest limitation, though both provisions have the same practical effect. In the Senate amendment, 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 taxable income. The excess taxable income with respect to any partnership is the amount which bears the same ratio to the partnership's adjusted taxable income as 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 bears to 30 percent of the adjusted taxable income of the partnership. This allows a partner of a partnership to deduct additional interest expense the partner may have paid or incurred to the extent the partnership could have deducted more business interest. The Senate amendment requires that excess taxable income be allocated in the same manner as nonseparately stated income and loss. As in the House bill, rules similar to these rules also apply to S corporations.

The Senate amendment provides a special rule for carryforward of disallowed partnership interest. In the case of a partnership, the general carryforward rule described in the discussion of the House bill does not apply. Instead, any business interest that is not allowed as a deduction to the partnership for the taxable year is allocated to each partner in the same manner as nonseparately stated taxable income or loss of the partnership. The partner may deduct its share of the partnership's excess business interest in any future year, but only against excess taxable income attributed to the partner by the partnership the activities of which gave rise to the excess business interest carryforward. Any such deduction requires a corresponding reduction in excess taxable income. Additionally, when excess business interest is allocated to a partner, the partner's basis in its partnership interest is reduced (but not below zero) by the amount of such allocation, even though the carryforward does not give rise to a partner deduction in the year of the basis reduction. However, the partner's deduction in a future year for interest carried forward does not reduce the partner's basis in the partnership interest. In the event the partner disposes of a partnership interest the basis of which has been so reduced, the partner's basis in such interest shall be increased, immediately before such disposition, by the amount that any such basis reductions exceed any amount of excess interest expense that has been treated as paid by the partner (i.e., excess interest expense that has been deducted by the partner against excess taxable income of the same partnership). This special rule does not apply to S corporations and their shareholders.

Exceptions

The Senate amendment exempts certain categories of taxpayers or trades or businesses from the interest limitation. First, any taxpayer that meets the $15 million gross receipts test of section 448(c) is exempt from the interest limitation.[696] Second, the Senate amendment expands the regulated public utilities exception in the House bill to include utilities where the rates for such furnishing or sale, as the case may be, have

[691] See section 4302 of the bill (Limitation on deduction of interest by domestic corporations which are members of an international financial reporting group).

[692] 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.

[693] The term ''State'' includes the District of Columbia. See sec. 7701(a)(10) (''The term 'State' shall be construed to include the District of Columbia where such construction is necessary to carry out provisions of this title'').

[694] The deduction for income attributable to domestic production activities is repealed effective for taxable years beginning after December 31, 2018. See section 13305 of the Senate amendment (Repeal of deduction for income attributable to domestic production activities).

[695] See section 11011 of the Senate amendment (Deduction for qualified business income).

[696] See section 13102 of the Senate amendment (Modifications of gross receipts test for use of cash method of accounting by corporations and partnerships). In the case of a sole proprietorship, the $15 million gross receipts test is applied as if the sole proprietorship were a corporation or partnership.

been established by the governing or rate-making body of an electric cooperative.

In the Senate amendment, at the taxpayer's election, 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, and therefore the limitation does not apply to such trades or businesses.[697] Similarly, at the taxpayer's election, any farming business,[698] as well as any business engaged in the trade or business of a specified agricultural or horticultural cooperative,[699] are not treated as trades or businesses for purposes of the limitation, and therefore the limitation does not apply to such trades or businesses.

CONFERENCE AGREEMENT

The conference agreement generally follows the Senate amendment, with the following modifications. Under the conference agreement, for taxable years beginning after December 31, 2017 and before January 1, 2022, adjusted taxable income is computed without regard to deductions allowable for depreciation, amortization, or depletion. Additionally, because the conference agreement repeals section 199 effective December 31, 2017, adjusted taxable income is computed without regard to such deduction. The conference agreement follows the House in exempting from the limitation taxpayers with average annual gross receipts for the three-taxable-year period ending with the prior taxable year that do not exceed $25 million. In addition, for purposes of defining floor plan financing, the conference agreement modifies the definition of motor vehicle by deleting the specific references to an automobile, a truck, a recreational vehicle, and a motorcycle because those terms are encompassed in the phrase, ''any self-propelled vehicle designed for transporting persons or property on a public street, highway, or road,'' which was also part of the definition in the Senate amendment.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

2. Modification of net operating loss deduction (sec. 3302 of the House bill, sec. 13302 of the Senate amendment, 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.[700] In general, an NOL may be carried back two years and carried over 20 years to offset taxable income in such years.[701] NOLs offset taxable income in the order of the taxable years to which the NOL may be carried.[702]

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.[703] Limitations are placed on the carryback of excess interest losses attributable to corporate equity reduction transactions.[704]

HOUSE BILL

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.[705] 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.

Effective date.—The provision allowing indefinite carryovers and modifying carrybacks generally applies to losses arising in taxable years beginning after December 31, 2017.[706]

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.

SENATE AMENDMENT

The Senate amendment follows the House bill, with the following modifications. First, provision limits the NOL deduction to 80 percent of taxable income (determined without regard to the deduction), for losses arising in taxable years beginning after December 31, 2022. The limitation does not apply to a property and casualty insurance company.

The provision repeals the two-year carryback and the special carryback provisions, but provides a two-year carryback in the case of certain losses incurred in the trade or business of farming. In addition, the Senate amendment provides a two-year carryback and 20-year carryforward for NOLs of a property and casualty insurance company (defined in section 816(a)) as an insurance company other than a life insurance company).

The provision does not increase NOL carryovers.

Effective date.—The provision allowing indefinite carryovers and modifying carrybacks applies to losses arising in taxable years beginning after December 31, 2017.

The provision limiting the NOL deduction applies to losses arising in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, except that the provision limits the NOL deduction to 80 percent of taxable income (determined without regard to the deduction) for losses arising in taxable years beginning after December 31, 2017.

3. Like-kind exchanges of real property (sec. 3303 of the House bill, and sec. 13303 of the Senate amendment, 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.[707] 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.[708] Section 1031 also does not apply to certain exchanges involving livestock[709] or foreign property.[710]

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).[711] The

[697] It is intended that any such real property trade or business, including such a trade or business conducted by a corporation or real estate investment trust, be included. Because this description of a real property trade or business refers only to the section 469(c)(7)(C) description, and not to other rules of section 469 (such as the rule of section 469(c)(2) that passive activities include rental activities or the rule of section 469(a) that a passive activity loss is limited under section 469), the other rules of section 469 are not made applicable by this reference. It is further intended that a real property operation or a real property management trade or business includes the operation or management of a lodging facility.

[698] As defined in section 263A(e)(4) (i.e., farming business means the trade or business of farming and includes the trade or business of operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots)). Treas. Reg. sec. 1.263A–4(a)(4) further defines a farming business as a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity. Examples of a farming business include the trade or business of operating a nursery or sod farm; the raising or harvesting of trees bearing fruit, nuts, or other crops; the raising of ornamental trees (other than evergreen trees that are more than six years old at the time they are severed from their roots); and the raising, shearing, feeding, caring for, training, and management of animals. A farming business also includes processing activities that are normally incident to the growing, raising, or harvesting of agricultural or horticultural products. See Treas. Reg. sec. 1.263A–4(a)(4)(i) and (ii). A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by another taxpayer, or merely buying and reselling plants or animals grown or raised by another taxpayer. See Treas. Reg. sec. 1.263A–4(a)(4)(i).

[699] As defined in new section 199A(g)(2) under the Senate amendment. See section 11011 of the Senate amendment (Deduction for qualified business income).

[700] Sec. 172(c).

[701] Sec. 172(b)(1)(A).

[702] Sec. 172(b)(2).

[703] Sec. 172(b)(1)(C) and (E).

[704] Sec. 172(b)(1)(D).

[705] Notwithstanding the amendments made by the provision and section 1304 of the House 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).

[706] See section 3101 of the House 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.

[707] Sec. 1031(a)(1).

[708] Sec. 1031(a)(2). A chose in action is a right that can be enforced by legal action.

[709] Sec. 1031(e).

[710] Sec. 1031(h).

[711] Treas. Reg. sec. 1.1031(a)–1(b).

different classes of property are: (1) depreciable tangible personal property;[712] (2) intangible or nondepreciable personal property;[713] and (3) real property.[714] 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 property of a ''like kind'' as this distinction relates to the grade or quality of the real estate,[715] while depreciable tangible personal properties must be either within the same General Asset Class[716] or within the same Product Class.[717]

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 non-qualifying 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.[718] 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.[719] No losses may be recognized from a like-kind exchange.[720]

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.[721] 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.[722]

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.[723]

The Treasury Department has issued regulations[724] and revenue procedures[725] providing guidance and safe harbors for taxpayers engaging in deferred like-kind exchanges.

HOUSE BILL

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.[726]

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.

SENATE AMENDMENT

The Senate amendment follows the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

4. Revision of treatment of contributions to capital (sec. 3304 of the House bill and sec. 118 of the Code)

PRESENT LAW

The gross income of a corporation does not include any contribution to its capital.[727] For purposes of this rule, a contribution to the capital of a corporation does not include any contribution in aid of construction or any other contribution from a customer or potential customer.[728] 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.[729] 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.[730]

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.[731] 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.[732] Similarly, the adjusted basis of any property acquired by a utility with a contribution in aid of construction is zero.[733]

HOUSE BILL

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.

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

[712] 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).

[713] 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.

[714] Treas. Reg. sec. 1.1031(a)–1(b) and (c).

[715] Treas. Reg. sec. 1.1031(a)–1(b).

[716] 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).

[717] 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).

[718] 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.

[719] 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.

[720] Sec. 1031(c).

[721] 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).

[722] Sec. 1223(1).

[723] Sec. 1031(a)(3).

[724] Treas. Reg. sec. 1.1031(k)–1(a) through (o).

[725] See Rev. Proc. 2000–37, 2000–40 I.R.B. 308, as modified by Rev. Proc. 2004–51, 2004–33 I.R.B. 294.

[726] 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).

[727] Sec. 118(a).

[728] Sec. 118(b).

[729] Sec. 118(c)(1).

[730] Sec. 118(c)(4).

[731] Sec. 362(c)(1).

[732] Sec. 362(c)(2). See also Treas. Reg. sec. 1.362–2.

[733] Sec. 118(c)(4).

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.[734] 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the policy of the House bill but takes a different approach. The conference agreement does not repeal the provision of the Internal Revenue Code under which, generally, a corporation's gross income does not include contributions to capital. Rather, it preserves that provision, but provides that the term ''contributions to capital'' does not include (1) any contribution in aid of construction or any other contribution as a customer or potential customer, and (2) any contribution by any governmental entity or civic group (other than a contribution made by a shareholder as such). The conferees intend that section 118, as modified, continue to apply only to corporations.

Effective date.—The provision applies to contributions made after the date of enactment. However, the provision shall not apply to any contribution made after the date of enactment by a governmental entity pursuant to a master development plan that has been approved prior to such date by a governmental entity.

5. Repeal of deduction for local lobbying expenses (sec. 3305 of the House bill, sec. 13308 of the Senate amendment, 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.[735] However, section 162(e) denies a deduction for amounts paid or incurred in connection with (1) influencing legislation,[736] (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 direct communication with a covered executive branch official[737] 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.[738]

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'').[739] 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.[740]

For purposes of this exception, legislation of an Indian tribal government is treated in the same manner as local legislation.[741]

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.[742]

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment follows the House bill other than to change the effective date so that the provision applies to amounts paid or incurred on or after the date of enactment.

Effective date.—The provision applies to amounts paid or incurred on or after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Repeal of deduction for income attributable to domestic production activities (sec. 3306 of the House bill, sec. 13305 of the Senate amendment, and sec. 199 of the Code)

PRESENT LAW

In general

Section 199 provides a deduction from taxable income (or, in the case of an individual, adjusted gross income[743]) 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.[744] 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.[745] 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.[746]

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[747] that was manufactured, produced, grown or extracted by the taxpayer in whole or in significant part within the United States;[748] (2) any sale, exchange, or other disposition, or any lease, rental, or license, of qualified film[749] produced by the taxpayer; (3) any

[734] Rev. Rul. 64–155, 1964–1 CB 138.

[735] Sec. 162(a).

[736] 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).

[737] 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 serving 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).

[738] Sec. 162(e)(5)(C).

[739] Sec. 162(e)(2)(A).

[740] Sec. 162(e)(2)(B).

[741] Sec. 162(e)(7).

[742] Sec. 162(e)(5)(B).

[743] 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).

[744] 7Sec. 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).

[745] This example assumes the deduction does not exceed the wage limitation discussed below.

[746] 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.

[747] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings. Sec. 199(c)(5).

[748] 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, 2017, 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). 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).

[749] 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

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.[750]

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.[751]

Agricultural and horticultural cooperatives

With regard to member-owned agricultural and horticultural cooperatives formed under Subchapter T of the Code, section 199 provides the same treatment of qualified production activities income derived from agricultural or horticultural products that are manufactured, produced, grown, or extracted by cooperatives,[752] or that are marketed through cooperatives, as it provides for qualified production activities income of other taxpayers (i.e., the cooperative may claim a deduction from qualified production activities income).

In addition, section 199(d)(3)(A) provides that the amount of any patronage dividends or per-unit retain allocations paid to a member of an agricultural or horticultural cooperative (to which Part I of Subchapter T applies), which is allocable to the portion of qualified production activities income of the cooperative that is deductible under the provision, is deductible from the gross income of the member. In order to qualify, such amount must be designated by the organization as allocable to the deductible portion of qualified production activities income in a written notice mailed to its patrons not later than the payment period described in section 1382(d). In addition, section 199(d)(3)(B) provides that the cooperative cannot reduce its income under section 1382 (*e.g.*, cannot claim a dividends-paid deduction) for such amounts.

HOUSE BILL

The provision repeals the deduction for income attributable to domestic production activities.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

Effective date.—The provision is effective for non-corporate taxpayers and for certain rules applicable to agricultural and horticultural cooperates provided in section 199(d)(3)(A) and (B) for taxable years beginning after December 31, 2017. The provision is effective for C corporations for taxable years beginning after December 31, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

7. Entertainment, etc. expenses (sec. 3307 of the House bill, sec. 13304 of the Senate amendment, 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.[753] 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.[754] Similarly, a deduction for any expense for food or beverages generally is limited to 50 percent of the amount otherwise deductible.[755] In addition, no deduction is allowed for membership dues with respect to any club organized for business, pleasure, recreation, or other social purpose.[756]

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.[757] 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.[758] 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.[759]

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.[760] 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.[761] 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.[762]

Expenses treated as compensation

Except as otherwise provided, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.[763] 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.[764] 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 non-commercial flight generally is determined under the base aircraft valuation formula, also known as the Standard Industry Fare Level formula or ''SIFL.''[765] 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.[766]

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.[767] 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.[768] 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).[769]

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 compensation 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.[770]

participations) constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers. Sec. 199(c)(6).

[750] Sec. 199(c)(4)(A).

[751] 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).

[752] For this purpose, agricultural or horticultural products also include fertilizer, diesel fuel and other supplies used in agricultural or horticultural production that are manufactured, produced, grown, or extracted by the cooperative.

[753] Sec. 274(a)(1).

[754] Sec. 274(n)(1)(B).

[755] Sec. 274(n)(1)(A).

[756] Sec. 274(a)(3).

[757] Sec. 274(e)(2)(A). See below for a discussion of the recent modification of this rule for certain individuals.

[758] Sec. 274(e)(9).

[759] Treas. Reg. sec. 1.162–25T(a).

[760] Sec. 274(e)(3).

[761] Sec. 274(e)(4).

[762] Sec. 274(n)(2)(E).

[763] Sec. 61(a)(1).

[764] Treas. Reg. sec. 1.61–21(b)(1).

[765] Treas. Reg. sec. 1.61–21(g)(5).

[766] Treas. Reg. sec. 1.61–21(b)(6).

[767] *Sutherland Lumber-Southwest, Inc. v. Commissioner*, 114 T.C. 197 (2000), aff'd, 255 F.3d 495 (8th Cir. 2001).

[768] 1ASec. 274(e)(2)(B)(i). See also Treas. Reg. sec. 1.274–9(a).

[769] Sec. 274(e)(2)(B)(ii). See also Treas. Reg. sec. 1.274–9(b).

[770] See Treas. Reg. sec. 1.274–10(a)(2).

Excludable fringe benefits

Certain employer-provided fringe benefits are excluded from an employee's gross income and wages for employment tax purposes, including, but not limited to, *de minimis* fringes, qualified transportation fringes, on-premises athletic facilities, and meals provided for the ''convenience of the employer.''[771]

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,[772] and also includes food and beverages provided to employees through an eating facility operated by the employer that is located on or near the employer's business premises and meets certain requirements.[773]

Qualified transportation fringes include qualified parking (parking 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.[774]

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.[775]

The value of meals furnished to an employee or the employee's spouse or dependents by or on behalf of an employer for the convenience of the employer is excludible from the employee's gross income, but only if such meals are provided on the employer's business premises.[776]

HOUSE BILL

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 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 employer) under a reimbursement or other expense allowance arrangement if the person for whom the services are performed is a tax-exempt entity[777] 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.

SENATE AMENDMENT

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, or (3) a facility or portion thereof used in connection with any of the above items. 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).

In addition, the provision disallows a deduction for expenses associated with providing any qualified transportation fringe to employees of the taxpayer, and except as necessary for ensuring the safety of an employee, any expense incurred for providing transportation (or any payment or reimbursement) for commuting between the employee's residence and place of employment.

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). For amounts incurred and paid after December 31, 2017 and until December 31, 2025, the provision expands this 50 percent limitation to expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer. Such amounts incurred and paid after December 31, 2025 are not deductible.

Effective date.—The provision generally applies to amounts paid or incurred after December 31, 2017. However, for expenses of the employer associated with providing food and beverages to employees through an eating facility that meets requirements for *de minimis* fringes and for the convenience of the employer, amounts paid or incurred after December 31, 2025 are not deductible.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

18. Repeal of exclusion, etc., for employee achievement awards (sec. 1403 of the House bill, sec. 13310 of the Senate amendment, 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.[778] 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.[779] 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.

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment adds a definition of ''tangible personal property'' that may be considered a deductible employee achievement award. It provides that tangible personal property shall not include cash, cash equivalents, gift cards, gift coupons or gift certificates (other than arrangements conferring only the right to select and receive tangible personal property from a limited array of such items pre-selected or pre-approved by the employer), or vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, other securities, and other similar items. No inference is intended that this is a change from present law and guidance.

Effective date.—The provision applies to amounts paid or incurred after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

[771] Secs. 132(a), 119(a), 3121(a)(19) and (20), 3231(e)(5) and (9), 3306(b)(14) and (16), and 3401(a)(19).

[772] 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).

[773] Sec. 132(e)(2). Revenue derived from such a facility must normally equal or exceed the direct operating costs of the facility. Employees who are entitled, under Section 119, to exclude the value of a meal provided at such a facility are treated as having paid an amount for the meal equal to the direct operating costs of the facility attributable to such meal.

[774] Sec. 132(f)(1), (5). The qualified transportation fringe exclusions are subject to monthly limits. Sec. 132(f)(2).

[775] Sec. 132(j)(4).

[776] Sec. 119(a).

[777] 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.

[778] Sec. 274(j).

[779] Sec. 74(c).

9. Unrelated business taxable income increased by amount of certain fringe benefit expenses for which deduction is disallowed (sec. 3308 of the House 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.[780] 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.[781] 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.[782] 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.[783] 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 stock bonus plans described in section 401(a); and (3) certain State colleges and universities.[784]

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,[785] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[786] 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

10. Limitation on deduction for FDIC premiums (sec. 3309 of the House bill, sec. 13531 of the Senate amendment, 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 income of a C corporation[787] 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.[788]

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.[789] 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.[790]

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.[791]

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 method of accounting for bad debts, repealed in 1986[792] 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.[793]

Credit unions

Credit unions are exempt from Federal income taxation.[794] 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.[795] While significant differences between the rules under which credit unions and banks operate have existed in the past,

[780] Secs. 511–514.

[781] Treas. Reg. sec. 1.501(c)(3)–1(e).

[782] Sec. 512(a).

[783] Treas. Reg. sec. 1.512(a)–1(a).

[784] Sec. 511(a)(2).

[785] Secs. 511–514.

[786] Sec. 512(b)(13).

[787] 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.

[788] 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.

[789] Sec. 581. See also Treas. Reg. sec. 1.581–1(a).

[790] 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).

[791] Sec. 1361(b)(2)(A).

[792] Tax Reform Act of 1986, Pub. L. No. 99–514.

[793] Sec. 585(b)(2).

[794] 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.

[795] 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.

most of those differences have disappeared over time.[796]

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.[797]

HOUSE BILL

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.[798] 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.[799]

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.

SENATE AMENDMENT

The Senate amendment follows the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

11. Repeal of rollover of publicly traded securities gain into specialized small business investment companies (sec. 3310 of the House 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.[800]

[796] 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.

[797] Technical Advice Memorandum 199924060, March 5, 1999, and Rev. Rul. 80–230, 1980–2 C.B. 169, 1980.

[798] 12 U.S.C. sec. 1817(b).

[799] Pub. L. No. 111–203.

[800] Sec. 1044(a).

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.[801] For corporations, these limits are $250,000 and $1 million, respectively.[802]

HOUSE BILL

The House bill 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

12. Certain self-created property not treated as a capital asset (sec. 3311 of the House 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.[803] 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),[804] 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.[805]

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.[806] 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.[807] However, a taxpayer may elect to treat musical compositions and copyrights in musical works as capital assets.[808]

[801] Sec. 1044(b)(1).

[802] Sec. 1044(b)(2).

[803] Sec. 1221(a).

[804] 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).

[805] Sec. 1221(a)(1)–(8).

[806] Sec. 1221(a)(3)(A) and (B).

[807] Sec. 1221(a)(3)(C).

[808] 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 application of this provision, gain from a sale of the compositions or copyrights is treated as capital gain, not ordinary income.

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.[809]

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

13. Repeal of special rule for sale or exchange of patents (sec. 3312 of the House bill and sec. 1235 of the Code))

PRESENT LAW

Section 1235 provides that a transfer[810] 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.[811]

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.[812]

HOUSE BILL

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.[813]

Effective date.—The provision applies to dispositions after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

[809] *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 52 (1955).

[810] A transfer by gift, inheritance, or devise is not included.

[811] Sec. 1235(a).

[812] Sec. 1235(b).

[813] See also section 3311 of the House bill (Certain self-created property not treated as a capital asset).

14. Repeal of technical termination of partnerships (sec. 3313 of the House bill and sec. 708(b) of the Code)

PRESENT LAW

A partnership is considered as terminated under specified circumstances.[814] Special rules apply in the case of the merger, consolidation, or division of a partnership.[815]

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.[816]

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.[817] 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.[818]

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.[819] Partnership-level elections generally cease to apply following a technical termination.[820] A technical termination generally results in the restart of partnership depreciation recovery periods.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

15. Recharacterization of certain gains in the case of partnership profits interests held in connection with performance of investment services (sec. 3314 of the House bill, sec. 13310 of the Senate amendment, and secs. 1061 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.[821]

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.[822] 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[823] 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.[824]

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.[825] 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.[826]

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).[827] 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.[828] 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.

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.[829] 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

[814] Sec. 708(b)(1).

[815] 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).

[816] Sec. 708(b)(1)(A).

[817] Sec. 708(b)(1)(B).

[818] Treas. Reg. sec. 1.708–1(b)(4).

[819] Sec. 706(c)(1); Treas. Reg. sec. 1.708–1(b)(3).

[820] 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.

[821] 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)).

[822] Rev. Proc. 93–27 (1993–2 C.B. 343), citing the *Diamond* and *Campbell* cases, *supra*.

[823] 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.

[824] 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).

[825] 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).

[826] Rev. Proc. 93–27, 1993–2 C.B. 343.

[827] 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.

[828] Sec. 83(h).

[829] Sec. 702.

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.[830]

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,[831] 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.

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.[832]

HOUSE BILL

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.

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[833]) 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 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

[830] 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.

[831] 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.

[832] Sec. 163(d).

[833] Sec. 318(a)(1).

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[834]) 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.

SENATE AMENDMENT

The Senate amendment is generally the same as the House bill, except with respect to the nonapplicability of section 83. Under the Senate amendment, the provision provides 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, notwithstanding the rules of section 83 or any election in effect under section 83(b).

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment. The conferees wish to clarify the interaction of section 83 with the provision's three-year holding requirement, which applies notwithstanding the rules of section 83 or any election in effect under section 83(b). Under the provision, the fact that an individual may have included an amount in income upon acquisition of the applicable partnership interest, or that an individual may have made a section 83(b) election with respect to an applicable partnership interest, does not change the three-year holding period requirement for long-term capital gain treatment with respect to the applicable partnership interest. Thus, 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.

[834] Sec. 318(a)(1).

16. Amortization of research and experimental expenditures (sec. 3315 of the House bill, sec. 13206 of the Senate amendment, 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 generally must be capitalized and depreciated over such useful life.[835] 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.[836] 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.[837] Taxpayers, alternatively, may elect to amortize their research expenditures over a period of 10 years.[838] Research and experimental expenditures deductible under section 174 are not subject to capitalization under either section 263(a)[839] or section 263A.[840]

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.[841] 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.[842] 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.[843] 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).[844] In addition, under administrative guidance, the costs of developing computer software have been accorded treatment similar to research expenditures.[845]

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.[846] 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.[847]

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.[848] 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.[849]

HOUSE BILL

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[850] 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 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

[835] Secs. 167 and 263(a).

[836] Secs. 174(a) and (e).

[837] 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.

[838] 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.

[839] Sec. 263(a)(1)(B).

[840] Sec. 263A(c)(2).

[841] 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.

[842] Treas. Reg. sec. 1.174–2(a)(1).

[843] *Ibid.*

[844] 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).

[845] Rev. Proc. 2000–50, 2000–2 C.B. 601.

[846] Treas. Reg. sec. 1.174–2(a)(6).

[847] Treas. Reg. sec. 1.174–2(a)(7).

[848] Sec. 174(c).

[849] 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).

[850] For this purpose, the term ''United States'' includes the United States, the Commonwealth of Puerto Rico, and any possession of the United States.

to amortize their research or experimental expenditures over a period of 10 years.[851]

Effective date.—The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2022.

SENATE AMENDMENT

The Senate amendment follows the House bill, except with the following modifications. The application of the Senate amendment is treated as a change in the taxpayer's method of accounting for purposes of section 481, initiated by the taxpayer, and made with the consent of the Secretary. The Senate amendment is applied on a cutoff basis to research or experimental expenditures paid or incurred in taxable years beginning after December 31, 2025 (hence there is no adjustment under section 481(a) for research or experimental expenditures paid or incurred in taxable years beginning before January 1, 2026). In addition, the Senate amendment makes conforming changes to sections 41 and 280C.

Effective date.—The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2025.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

Effective date.—The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2021.

17. Certain special rules for taxable year of inclusion (sec. 13221 of the Senate amendment and sec. 451 of the Code)

PRESENT LAW

In general

Under section 61(a), gross income generally includes all income from whatever source derived, except as otherwise provided in Subtitle A of the Code. Thus, gross income generally includes income realized in any from, whether in money, property, or services, except to the extent provided in other sections of the Code.[852] Once it is determined that an item of gross income is clearly realized for Federal income tax purposes, section 451 and the regulations thereunder provide the general rules as to the timing of when such item is to be included in gross income.[853]

A taxpayer generally is required to include an item in gross income no later than the time of its actual or constructive receipt, unless the item properly is accounted for in a different period under the taxpayer's method of accounting.[854] If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.[855]

In general, for a cash basis taxpayer, an amount is included in gross income when actually or constructively received. For an accrual basis taxpayer, an amount is included in gross income when all the events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy (*i.e.*, when the ''all events test'' is met), unless an exception permits deferral or exclusion, or a special method of accounting applies.[856]

A number of exceptions that exist to permit deferral of gross income relate to advance payments. An advance payment is when a taxpayer receives payment before the taxpayer provides goods or services to its customer. The exceptions often allow tax deferral to mirror financial accounting deferral (*e.g.*, income is recognized as the goods are provided or the services are performed).[857]

Interest income

A taxpayer generally must include in gross income the amount of interest received or accrued within the taxable year on indebtedness held by the taxpayer.[858]

Original issue discount

The holder of a debt instrument with original issue discount (''OID'') generally accrues and includes the OID in gross income as interest over the term of the instrument, regardless of when the stated interest (if any) is paid.[859]

The amount of OID with respect to a debt instrument is the excess of the stated redemption price at maturity over the issue price of the debt instrument.[860] The stated redemption price at maturity is the sum of all payments provided by the debt instrument other than qualified stated interest payments.[861] The holder includes in gross income an amount equal to the sum of the daily portions of the OID for each day during the taxable year the holder held such debt instrument. The daily portion is determined by allocating to each day in any accrual period its ratable portion of the increase during such accrual period in the adjusted issue price of the debt instrument.[862] The adjustment to the issue price is determined by multiplying the adjusted issue price (*i.e.*, the issue price increased by adjustments prior to the accrual period) by the instrument's yield to maturity, and then subtracting the interest payable during the accrual period. Thus, to compute the amount of OID and the portion of OID allocable to a period, the stated redemption price at maturity and the term must be known. Issuers of OID instruments accrue and deduct the amount of OID as interest expense in the same manner as the holder.[863]

Debt instruments subject to acceleration

Special rules for determining the amount of OID allocated to a period apply to certain instruments that may be subject to prepayment. If a borrower can reduce the yield on a debt by exercising a prepayment option, the OID rules assume that the borrower will prepay the debt.[864] In addition, in the case of (1) any regular interest in a real estate mortgage investment conduit (''REMIC'') or qualified mortgages held by a REMIC or (2) any other debt instrument if payments under the instrument may be accelerated by reason of prepayments of other obligations securing the instrument, the daily portions of the OID on such debt instruments are determined by taking into account an assumption regarding the prepayment of principal for such instruments.[865]

The Taxpayer Relief Act of 1997[866] extended these rules to any pool of debt instruments the payments on which may be accelerated by reason of prepayments.[867] Thus, if a taxpayer holds a pool of credit card receivables that require interest to be paid only if the borrowers do not pay their accounts by a specified date (''grace-period interest''), the taxpayer is required to accrue interest or OID on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. Under these rules, certain amounts (other than grace-period interest) related to credit card transactions, such as late-payment fees,[868] cash-advance fees,[869] and interchange fees,[870] have been determined to create OID or increase the amount of OID on the pool of credit card receivables to which the amounts relate.[871]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision revises the rules associated with the timing of the recognition of income.[872] Specifically, the provision requires an accrual method taxpayer subject to the all events test for an item of gross income to recognize such income no later than the taxable year in which such income is taken into account as revenue in an applicable financial statement[873] or another financial statement under rules specified by the Secretary, but provides an exception for taxpayers without

[851] See section 2001 of the House bill (Repeal of alternative minimum tax).

[852] Treas. Reg. sec. 1.61–1.

[853] Treas. Reg. sec. 1.61–1(b)(3).

[854] Sec. 451(a).

[855] See Treas. Reg. sec. 1.451–2.

[856] See Treas. Reg. secs. 1.446–1(c)(1)(ii) and 1.451–1(a).

[857] For examples of provisions permitting deferral of advance payments, see Treas. Reg. sec. 1.451–5 and Rev. Proc. 2004–34, 2004–1 C.B. 991, as modified and clarified by Rev. Proc. 2011–18, 2011–5 I.R.B. 443, and Rev. Proc. 2013–29, 2013–33 I.R.B. 141.

[858] Secs. 61(a)(4) and 451.

[859] Sec. 1272.

[860] Sec. 1273(a)(1).

[861] Sec. 1273(a)(2) and Treas. Reg. sec. 1.1273–1(b).

[862] Sec. 1272(a)(1) and (3).

[863] Sec. 163(e).

[864] Treas. Reg. sec. 1.1272–1(c)(5).

[865] Sec. 1272(a)(6).

[866] Pub. L. No. 105–34, sec. 1004(a).

[867] Sec. 1272(a)(6)(C)(iii).

[868] Rev. Proc. 2004–33, 2004–1 C.B. 989.

[869] Rev. Proc. 2005–47, 2005–2 C.B. 269.

[870] *Capital One Financial Corp. and Subsidiaries v. Commissioner*, 133 T.C. No. 8 (2009); IRS Chief Counsel Notice CC–2010–018, September 27, 2010.

[871] See also Rev. Proc. 2013–26, 2013–22 I.R.B. 1160, for a safe harbor method of accounting for OID on a pool of credit card receivables for purposes of section 1272(a)(6).

[872] The provision does not revise the rules associated with when an item is realized for Federal income tax purposes and, accordingly, does not require the recognition of income in situations where the Federal income tax realization event has not yet occurred. For example, the provision does not require the recharacterization of a transaction from sale to lease, or vice versa, to conform to how the transaction is reported in the taxpayer's applicable financial statement. Similarly, the provision does not require the recognition of gain or loss from securities that are marked to market for financial reporting purposes if the gain or loss from such investments is not realized for Federal income tax purposes until such time that the taxpayer sells or otherwise disposes of the investment. As a further example, income from investments in corporations or partnerships that are accounted for under the equity method for financial reporting purposes will not result in the recognition of income for Federal income tax purposes until such time that the Federal income tax realization even has occurred (*e.g.*, when the taxpayer receives a dividend from the corporation in which it owns less than a controlling interest or when the taxpayer receives its allocable share of income, deductions, gains, and losses on its Schedule K–1 from the partnership).

[873] For purposes of the provision, 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 (''SEC''), (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 agency for purposes other than Federal tax purposes, but only if there is no statement of the taxpayer described in clause (i) or (ii); (B) a financial statement which is made on the basis of international financial reporting standards and is filed by the taxpayer with an agency of a foreign government which is equivalent to the SEC and which has reporting standards not less stringent than the standards required by such Commission, but only if there is no statement of the taxpayer described in subparagraph (A); or (C) a financial statement filed by the taxpayer with any other regulatory or governmental body specified by the Secretary, but only if there is no statement of the taxpayer described in subparagraph (A) or (B). If the financial results of a taxpayer are reported on the applicable financial statement for a group of entities, such statement is treated as the applicable financial statement of the taxpayer.

an applicable or other specified financial statement.[874] In the case of a contract which contains multiple performance obligations, the provision allows the taxpayer to allocate the transaction price in accordance with the allocation made in the taxpayer's applicable financial statement.

In addition, the provision directs accrual method taxpayers with an applicable financial statement to apply the income recognition rules under section 451 before applying the special rules under part V of subchapter P, which, in addition to the OID rules, also includes rules regarding the treatment of market discount on bonds, discounts on short-term obligations, OID on tax-exempt bonds, and stripped bonds and stripped coupons.[875] Thus, for example, to the extent amounts are included in revenue for financial statement purposes when received (*e.g.*, late-payment fees, cash-advance fees, or interchange fees), such amounts generally are includable in income at such time in accordance with the general recognition principles under section 451. The provision provides an exception for any item of gross income in connection with a mortgage servicing contract. Thus, under the provision, income from mortgage servicing rights will continue to be recognized in accordance with the present law rules for such items of gross income (*i.e.*, ''normal'' mortgage servicing rights will be included in income upon the earlier of earned or received under the all events test of section 451 (*i.e.*, not averaged over the life of the mortgage),[876] and ''excess'' mortgage servicing rights will be treated as stripped coupons under section 1286 and therefore subject to the original issue discount rules[877]).

The provision also codifies the current deferral method of accounting for advance payments for goods, services, and other specified items provided by the IRS under Revenue Procedure 2004–34.[878] That is, the provision allows accrual method taxpayers to elect[879] to defer the inclusion of income associated with certain advance payments to the end of the tax year following the tax year of receipt if such income also is deferred for financial statement purposes.[880] In the case of advance payments received for a combination of services, goods, or other specified items, the provision allows the taxpayer to allocate the transaction price in accordance with the allocation made in the taxpayer's applicable financial statement. The provision requires the inclusion in gross income of a deferred advance payment if the taxpayer ceases to exist.

The application of these rules is a change in the taxpayer's method of accounting for purposes of section 481. In the case of any taxpayer required by this provision to change its method of accounting for its first taxable year beginning after December 31, 2017, such change is treated as initiated by the taxpayer and made with the consent of the Secretary. In the case of income from a debt instrument having OID, the related section 481(a) adjustment is taken into account over six taxable years.

Effective date.—The provision generally applies to taxable years beginning after December 31, 2017. In the case of income from a debt instrument having OID, the provision applies to taxable years beginning after December 31, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

18. Denial of deduction for certain fines, penalties, and other amounts (sec. 13306 of the Senate amendment and sec. 162(f) and new sec. 6050X of the Code)

PRESENT LAW

The Code denies a deduction for fines or penalties paid to a government for the violation of any law.[881]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision denies deductibility for any otherwise deductible amount paid or incurred (whether by suit, agreement, or otherwise) to or at the direction of a government or specified nongovernmental entity in relation to the violation of any law or the investigation or inquiry by such government or entity into the potential violation of any law. An exception applies to payments that the taxpayer establishes are either restitution (including remediation of property) or amounts required to come into compliance with any law that was violated or involved in the investigation or inquiry, that are identified in the court order or settlement agreement as restitution, remediation, or required to come into compliance. In the case of any amount of restitution for failure to pay any tax and assessed as restitution under the Code, such restitution is deductible only to the extent it would have been allowed as a deduction if it had been timely paid. The IRS remains free to challenge the characterization of an amount so identified; however, no deduction is allowed unless the identification is made. Restitution or included remediation of property does not include reimbursement of government investigative or litigation costs.

The provision applies only where a government (or other entity treated in a manner similar to a government under the provision) is a complainant or investigator with respect to the violation or potential violation of any law.[882] An exception also applies to any amount paid or incurred as taxes due.

The provision requires government agencies (or entities treated as such agencies under the provision) to report to the IRS and to the taxpayer the amount of each settlement agreement or order entered into where the aggregate amount required to be paid or incurred to or at the direction of the government is at least $600 (or such other amount as may be specified by the Secretary of the Treasury as necessary to ensure the efficient administration of the Internal Revenue laws). The report must separately identify any amounts that are for restitution or remediation of property, or correction of noncompliance. The report must be made at the time the agreement is entered into, as determined by the Secretary of the Treasury.

Effective date.—The provision denying the deduction and the reporting provision are effective for amounts paid or incurred on or after the date of enactment, except that it would not apply to amounts paid or incurred under any binding order or agreement entered into before such date. Such exception does not apply to an order or agreement requiring court approval unless the approval was obtained before such date.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

19. Denial of deduction for settlements subject to nondisclosure agreements paid in connection with sexual harassment or sexual abuse (sec. 13307 of the Senate amendment and new sec. 162(q) of the Code)

PRESENT LAW

A taxpayer generally is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business.[883] 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.

HOUSE BILL

No provision.

SENATE AMENDMENT

Under the provision, no deduction is allowed for any settlement, payout, or attorney fees related to sexual harassment or sexual abuse if such payments are subject to a nondisclosure agreement.

Effective date.—The provision is effective for amounts paid or incurred after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

[874] The Committee intends that the provision apply to items of gross income for which the timing of income inclusion is determined using the all events test under present law. Under the provision, an accrual method taxpayer with an applicable financial statement will include an item in income under section 451 upon the earlier of when the all events test is met or when the taxpayer includes such item in revenue in an applicable financial statement. For example, under the provision, any unbilled receivables for partially performed services must be recognized to the extent the amounts are taken into income for financial statement purposes. However, accrual method taxpayers without an applicable or other specified financial statement will continue to determine income inclusion under the all events test, unless an exception permits deferral or exclusion. See sec. 451(a) and Treas. Reg. sec. 1.451–1(a). The Committee intends that the financial statement conformity requirement added to section 451 not be construed as preventing the use of special methods of accounting provided elsewhere in the Code, other than part V of subchapter P (special rules for bonds and other debt instruments) excluding items of gross income in connection with a mortgage servicing contract. For example, it does not preclude the use of the installment method under section 453 or the use of long-term contract methods under section 460. See Treas. Reg. sec. 1.446–1(c)(1)(iii).

[875] Secs. 1271–1288.

[876] See Rev. Rul. 70–142, 1970–2 C.B. 115.

[877] See Rev. Rul. 91–6, 1991–2, C.B. 358, and Rev. Proc. 91–50, 1991–2 C.B. 778.

[878] 2004–1 C.B. 991, as modified and clarified by Rev. Proc. 2011–18, 2011–5 I.R.B. 443, and Rev. Proc. 2013–29, 2013–33 I.R.B. 141.

[879] The election shall be made at such time, in such form and manner, and with respect to such categories of advance payments as the Secretary may provide. For these purposes, the recognition of income under such election is treated as a method of accounting.

[880] Thus, the provision is intended to override any deferral method provided by Treasury Regulation section 1.451 095 for advance payments received for goods.

[881] Sec. 162(f).

[882] Thus, for example, the provision does not apply to payments made by one private party to another in a lawsuit between private parties, merely because a judge or jury acting in the capacity as a court directs the payment to be made. The mere fact that a court enters a judgment or directs a result in a private dispute does not cause the payment to be made ''at the direction of a government'' for purposes of the provision.

[883] Sec. 162(a).

20. Uniform treatment of expenses in contingency fee cases (sec. 3316 of the House 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.[884]

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,[885] others have allowed the current deduction because the right of reimbursement was uncertain,[886] and other cases have denied the current deduction 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.[887] 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.[888]

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.[889] 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.[890]

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

[884] Sec. 162(a); Treas. Reg. sec. 1.162–1(a).

[885] *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).

[886] *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.

[887] *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.

[888] *Boccardo v. Commissioner*, 12 Cl Ct. 184 (1987); *Boccardo v. Commissioner*, 65 T.C.M. 2739 (1993).

[889] *Boccardo v. Commissioner*, 56 F.3d 1016 (9th Cir. 1995), rev'g 65 T.C.M. 2739 (1993).

[890] 1997 FSA LEXIS 442 (June 2, 1997).

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 House bill, sec. 13401 of the Senate amendment, 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 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.[891] 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.[892]

Amounts included in computing the credit under this section are excluded from the computation of the research credit under section 41.[893]

HOUSE BILL

The House bill 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.

SENATE AMENDMENT

The Senate amendment reduces the credit rate to 27.5 percent of qualified clinical testing expenses.

Effective date.—The provision applies to amounts paid or incurred in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, but reduces the credit rate to 25 percent of qualified clinical testing expenses.

2. Repeal of employer-provided child care credit (sec. 3402 of the House bill and sec. 42F 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.[894]

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;[895] (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 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.

[891] Sec. 45C(b).

[892] Sec. 45C(d).

[893] Sec. 45C(c).

[894] Sec. 38(b)(15).

[895] 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.

HOUSE BILL

The House bill 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The Conference agreement does not follow the House bill provision.

3. Rehabilitation credit (sec. 3403 of the House bill, sec. 13402 of the Senate amendment, 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.

HOUSE BILL

The House bill 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.

SENATE AMENDMENT

The Senate amendment repeals the 10-percent credit for pre-1936 buildings. The provision retains the 20-percent credit for qualified rehabilitation expenditures with respect to a certified historic structure, with a modification. Under the provision, the credit allowable for a taxable year during the five-year period beginning in the taxable year in which the qualified rehabilitated building is placed in service is an amount equal to the ratable share. The ratable share for a taxable year during the five-year period is amount equal to 20 percent of the qualified rehabilitation expenditures for the building, as allocated ratably to each taxable year during the five-year period. It is intended that the sum of the ratable shares for the taxable years during the five-year period does not exceed 100 percent of the credit for qualified rehabilitation expenditures for the qualified rehabilitated building.

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 (for a pre-1936 building) with respect to any building owned or leased (as provided under present law) 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.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with a modification to the transition rule under the effective date relating to qualified rehabilitation expenditures under certain phased rehabilitations for which the taxpayer may select a 60-month period.

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 (for either a certified historic structure or a pre-1936 building), with respect to any building owned or leased (as provided under present law) by the taxpayer at all times on and after January 1, 2018, the 24-month period selected by the taxpayer (section 47(c)(1)(C)(i)), or the 60-month period selected by the taxpayer under the rule for phased rehabilitation (section 47(c)(1)(C)(ii)), 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 or 60-month period ends.

4. Repeal of work opportunity tax credit (sec. 3404 of the House 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

5. Repeal of deduction for certain unused business credits (sec. 3405 of the House bill, sec. 13403 of the Senate amendment, 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.[896] 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.[897]

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.[898]

HOUSE BILL

This provision repeals the deduction for certain unused business credits.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment follows the House bill.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

6. Termination of new markets tax credit (sec. 3406 of the House 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").[899] 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.[900] The credit is determined by applying the applicable percentage (five or six

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[896] Sec. 38.

[897] Sec. 39.

[898] Sec. 196(d).

[899] Section 45D was added by section 121(a) of the Community Renewal Tax Relief Act of 2000, Pub. L. No. 106–554.

[900] Sec. 45D(a)(2).

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.[901] 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.[902]

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.[903] 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.[904] 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 businesses; (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.[905]

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.[906] 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.[907] 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[908] (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 attributable to certain financial property or to certain collectibles.[909]

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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

7. Repeal of credit for expenditures to provide access to disabled individuals (sec. 3407 of the House 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.[910]

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.[911] These expenditures[912] include: (1) removal of architectural, communication, physical or transportation barriers which prevent a business from being usable or accessible to individuals with disabilities;[913] (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 disabilities; 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.[914]

HOUSE BILL

The House bill repeals the credit for eligible access expenditures.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

8. Modification of credit for portion of employer social security taxes paid with respect to employee tips (sec. 3408 of the House 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'')[915] 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.[916] 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.

Reporting and allocation requirements

Employees are required to report monthly tips to their employer.[917] Certain large[918] 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

[901] Sec. 45D(a)(3).
[902] Sec. 45D(g).
[903] Sec. 45D(c).
[904] Sec. 45D(b).
[905] Sec. 45D(d).
[906] Sec. 45D(e).
[907] Sec. 45D(e)(2).
[908] Pub. L. No. 103–325.

[909] Sec. 45D(d)(2).
[910] Sec. 38(b)(17).
[911] As in effect on November 5, 1990. Sec. 44(c)(1).
[912] 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).
[913] Expenses related to this removal are not eligible in connection with facilities placed in service after November 5, 1990. Sec. 44(c)(4).

[914] 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.
[915] 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.
[916] 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.
[917] Sec. 6053(a).
[918] 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.

an amount equal to eight percent of gross receipts in excess of the amount of tips reported by such employees.[919] Employee tip income that is reported by employees is treated as employer-provided wages subject to FICA.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

9. Employer credit for paid family and medical leave (sec. 13403 of the Senate amendment, and new sec. 45S of the Code)

PRESENT LAW

Present law does not provide a credit to employers for compensation paid to employees while on leave.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision allows eligible employers to claim a general business credit equal to 12.5 percent of the amount of wages paid to qualifying employees during any period in which such employees are on family and medical leave if the rate of payment under the program is 50 percent of the wages normally paid to an employee. The credit is increased by 0.25 percentage points (but not above 25 percent) for each percentage point by which the rate of payment exceeds 50 percent. The maximum amount of family and medical leave that may be taken into account with respect to any employee for any taxable year is 12 weeks.

An eligible employer is one who has in place a written policy that allows all qualifying full-time employees not less than two weeks of annual paid family and medical leave, and who allows all less-than-full-time qualifying employees a commensurate amount of leave on a pro rata basis. For purposes of this requirement, leave paid for by a State or local government is not taken into account. A ''qualifying employee'' means any employee as defined in section 3(e) of the Fair Labor Standards Act of 1938 who has been employed by the employer for one year or more, and who for the preceding year, had compensation not in excess of 60 percent of the compensation threshold for highly compensated employees.[920] The Secretary will make determinations as to whether an employer or an employee satisfies the applicable requirements for an eligible employer or qualifying employee, based on information provided by the employer.

''Family and medical leave'' is defined as leave described under sections 102(a)(1)(a)-(e) or 102(a)(3) of the Family and Medical Leave Act of 1993.[921] If an employer provides paid leave as vacation leave, personal leave, or other medical or sick leave, this paid leave would not be considered to be family and medical leave.

This proposal would not apply to wages paid in taxable years beginning after December 31, 2019.

Effective date.—The provision is generally effective for wages paid in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

F. Energy Credits

1. Modifications to credit for electricity produced from certain renewable resources (sec. 3501 of the House 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'').[922] 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.[923] 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.[924]

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.

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'').[925] 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'').[926] Both methods require that a taxpayer make continuous progress towards completion once construction has begun.[927] 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.[928] Collectively, these two tests are referred to as the ''continuity requirement.''[929]

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

2. Modification of the energy investment tax credit (sec. 3502 of the House bill and sec. 48 of the Code)

PRESENT LAW

In general

A permanent, nonrefundable, 10-percent business energy credit[930] 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

[919] Sec. 6053(c).

[920] Sec. 414(g)(1)(B) ($120,000 for 2017).

[921] In order to be an eligible employer, an employer must provide certain protections applicable under the Family and Medical Leave Act of 1993, regardless of whether they otherwise apply. Specifically, the employer must provide paid family and medical leave in compliance with a policy which ensures that the employer will not interfere with, restrain, or deny the exercise of or the attempt to exercise, any right provided under the policy and will not discharge or in any other manner discriminate against any individual for opposing any practice prohibited by the policy.

[922] 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.

[923] The most recent inflation adjustment factors can be in IRS Notice 2017–33, I.R.B. 2017–22, May 30, 2017.

[924] Sec. 48(a)(5).

[925] IRS Notice 2013–29, 2013–20 I.R.B. 1085, April 14, 2013.

[926] Ibid.

[927] Ibid. See also, Notice 2016–31, 2016–23 I.R.B. 1025, May 5, 2016.

[928] Ibid.

[929] Notice 2016–31, 2016–23 I.R.B. 1025, May 5, 2016.

[930] Sec. 48.

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.[931] An unused general business credit generally may be carried back one year and carried forward 20 years.[932] 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 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. In the case of non-wind facilities, to make this election, construction must begin before January 1, 2017. For wind facilities, the 30-percent credit rate is reduced by 20 percent in the case of any wind facility the construction of which begins in calendar year 2017, by 40 percent in the case of any wind facility the construction of which begins in calendar year 2018, and by 60 percent in the case of any wind facility the construction of which begins in calendar year 2019. The credit for wind facilities expires for facilities the construction of which begins after calendar year 2019.

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'').[933] 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'').[934] Both methods require that a taxpayer make continuous progress towards completion once construction has begun.[935] 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 taxpayers relying on the five percent safe harbor must show ''continuous effort'' to complete the project.[936] Collectively, these two tests are referred to as the ''continuity requirement.''[937]

HOUSE BILL

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 includes a special rule for determining the beginning of construction, which is intended to adopt 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 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.

SENATE AMENDMENT

No provision.

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[931] Sec. 38(b)(1).

[932] Sec. 39.

[933] IRS Notice 2013–29, 2013–20 I.R.B. 1085, April 14, 2013.

[934] *Ibid.*

[935] *Ibid.* See also, Notice 2016–31, 2016–23 I.R.B. 1025, May 5, 2016.

[936] *Ibid.*

[937] Notice 2016–31, 2016–23 I.R.B. 1025, May 5, 2016.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

3. Extension and phaseout of residential energy efficient property credit (sec. 3503 of the House 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

4. Repeal of enhanced oil recovery credit (sec. 3504 of the House 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.

HOUSE BILL

The provision repeals the enhanced oil recovery credit.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

5. Repeal of credit for producing oil and gas from marginal wells (sec. 3505 of the House 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

6. Modification of credit for production from advanced nuclear power facilities (sec. 3506 of the House 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.[938] 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.[939]

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 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

[938] 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).

[939] I.R.S. Notice 2013–68.

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.

HOUSE BILL

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.[940] 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 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include in the House bill.

G. Bond Reforms

1. Termination of private activity bonds (sec. 3601 of the House 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.[941] 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, 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).[942]

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.[943]

Qualified private activity bonds

As stated, interest on private activity bonds is taxable unless the bonds meet the requirements for qualified private activity bonds. 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.[944] 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.[945]

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.[946]

HOUSE BILL

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.[947]

Effective date.—The provision applies to bonds issued after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

[940] 7 U.S.C. sec. 901 et seq.
[941] Sec. 103.
[942] Sec. 141(b)(4).
[943] Sec. 141(b)(5).
[944] Sec. 141(e).
[945] Sec. 142(a).
[946] Sec. 3.20 of Rev. Proc. 2016–55, 2016–2 C.B. 707.
[947] 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).

2. Repeal of advance refunding bonds (sec. 3602 of the House bill, sec. 13532 of the Senate amendment, 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 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).[948] 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.[949] 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.[950] Private activity bonds, other than qualified 501(c)(3) bonds, may not be advance refunded at all.[951] 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.[952]

HOUSE BILL

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

Effective date.—The provision applies to advance refunding bonds issued after December 31, 2017.

SENATE AMENDMENT

The Senate amendment follows the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

[948] Sec. 141.

[949] Sec. 149(d)(5).

[950] 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.

[951] Sec. 149(d)(2).

[952] 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.

3. Repeal of tax credit bonds (sec. 3603 of the House 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.[953]

Qualified tax-credit bonds

General rules applicable to qualified tax-credit bonds[954]

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.[955] 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.[956] 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 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.[957]

[953] 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.

[954] 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'').

[955] However, for new clean renewable energy bonds and qualified energy conservation bonds, the applicable credit rate is 70 percent of the otherwise applicable rate.

[956] Sec. 54C.

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;[958] (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
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.[959]

Qualified zone academy bonds

Qualifies zone academy bonds (''QZABs'') are defined as any bond issued by a State or

[957] 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.

[958] 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.

[959] 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.

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 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

4. No tax-exempt bonds for professional stadiums (sec. 3604 of the House sbill 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.''[960]

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:

More than 10 percent of the proceeds of the issue (including use of the bond-financed property) are to be used in the trade or business of any person other than a governmental unit (''private business use test''); and

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'').[961]

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.[962]

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.[963] 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.[964] 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 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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

H. Insurance

1. Net operating losses of life insurance companies (sec. 3701 of the House bill, sec. 13511 of the Senate amendment, 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.[965]

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.[966]

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.[967] A life insurance company is permitted to treat a loss from operations (as defined under section 810(c)) for any taxable year as an operations loss carryback to each of the three

[960] Sec. 141.

[961] 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.

[962] Treas. Reg. sec. 1.141–4(c)(3).

[963] Sec. 141(e).

[964] 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).

[965] Sec. 172(b)(2).

[966] Sec. 56(d).

[967] Secs. 810, 805(a)(5).

taxable years preceding the loss year and an operations loss carryover to each of the 15 taxable years following the loss year.[968]

HOUSE BILL

The provision repeals the operations loss deduction for life insurance companies and allows the NOL deduction under section 172.

Effective date.—The provision applies to losses arising in taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

2. Repeal of small life insurance company deduction (sec. 3702 of the House bill, sec. 13512 of the Senate amendment, 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.

HOUSE BILL

The provision repeals the small life insurance company deduction.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

3. Surtax on life insurance company taxable income (sec. 3703 of the House 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.

HOUSE BILL

The provision imposes an additional eight-percent income tax on life insurance company taxable income.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill provision.

4. Adjustment for change in computing reserves (sec. 3704 of the House bill, sec. 13513 of the Senate amendment, 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.[969]

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 a net increase in reserves.[970] 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.[971] 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.

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

5. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account (sec. 3705 of the House bill, sec. 13514 of the Senate amendment, 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 exceeded 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[972] 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.[973]

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.

HOUSE BILL

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

In the case of any stock life insurance company with an existing policyholders surplus account (as defined in section 815 before its repeal), tax is imposed on the balance of the account as of December 31, 2017. A life insurance company is required to pay tax on the balance of the account ratably over the first eight taxable years beginning after December 31, 2017. Specifically, the tax imposed on a life insurance company is the tax on the sum of 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

[968] Sec. 810(b)(1).

[969] See, *e.g.*, Rev. Proc. 2015–13, 2015–5 I.R.B. 419, and Rev. Proc. 2017–30, 2017–18 I.R.B. 1131.

[970] Sec. 807.

[971] Sec. 807(f).

[972] Pub. L. No. 98–369.

[973] Sec. 815.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

6. Modification of proration rules for property and casualty insurance companies (sec. 3706 of the House bill, sec. 13515 of the Senate amendment, 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.[974] 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.

HOUSE BILL

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.

SENATE AMENDMENT

The provision replaces the 15-percent reduction under present law with a reduction equal to 5.25 percent divided by the top corporate tax rate. For 2018, the top corporate tax rate is 35 percent, and the percentage reduction is 15 percent. For 2019 and thereafter, the corporate tax rate is 20 percent, and the percentage reduction is 26.25 percent under the proration rule for property and casualty insurance companies. The proration percentage will be automatically adjusted in the future if the top corporate tax rate is changed, so that the product of the proration percentage and the top corporate tax rate always equals 5.25 percent.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment. The top corporate tax rate is 21 percent for 2018 and thereafter,[975] so the percentage reduction is 25 percent under the proration rule for property and casualty insurance companies.

7. Modification of discounting rules for property and casualty insurance companies (sec. 3707 of the House bill and sec. 832 of the Code)

PRESENT LAW

A property and casualty insurance company generally is subject to tax on its taxable income.[976] 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.[977] 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.[978] 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.

HOUSE BILL

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.[979] 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 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

[974] Sec. 832(b)(5).

[975] See Part II.A.1 (Reduction in corporate tax rate).

[976] Sec. 831(a).

[977] Sec. 832.

[978] 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.

[979] 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.

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill with modifications. The corporate bond yield curve means, with respect to any month, a yield curve that reflects the average, for the preceding 60-month period (not 24-month period), of monthly yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available. The present-law three-year period for discounting certain lines of business other than long-tail lines of business is not modified under the conference agreement. The present-law 10-year period for certain long tail lines of business is extended for a maximum of 14 more years (instead of 15 more years as under the House bill). The present-law election permitting a taxpayer to use its own (rather than an aggregate industry-experience-based) historical loss payment pattern is repealed.

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 House bill, sec. 13516 of the Senate amendment, 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.[980] 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. Legislative history[981] 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.

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

9. Computation of life insurance tax reserves (sec. 13517 of the Senate amendment and sec. 807 of the Code)

PRESENT LAW

In general

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.[982] 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

[980] Sec. 847.

[981] 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.

[982] Sec. 807.

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.

Interest rate

The assumed interest rate to be used in computing the Federally prescribed reserve is the greater of the applicable Federal interest rate or the prevailing State assumed interest rate. The applicable Federal interest rate is the annual rate determined by the Secretary under the discounting rules for property and casualty reserves for the calendar year in which the contract is issued. The prevailing State assumed interest rate is generally the highest assumed interest rate permitted to be used in at least 26 States in computing life insurance reserves for insurance or annuity contracts of that type as of the beginning the calendar year in which the contract is issued. In determining the highest assumed rates permitted in at least 26 States, each State is treated as permitting the use of every rate below its highest rate.

A one-time election is permitted (revocable only with the consent of the Secretary) to apply an updated applicable Federal interest rate every five years in calculating life insurance reserves. The election is provided to take account of the fluctuations in market rates of return that companies experience with respect to life insurance contracts of long duration. The use of the updated applicable Federal interest rate under the election does not cause the recalculation of life insurance reserves for any prior year. Under the election no change is made to the interest rate used in determining life insurance reserves if the updated applicable Federal interest rate is less than one-half of one percentage point different from the rate used by the company in calculating life insurance reserves during the preceding five years.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision provides that for purposes of determining the deduction for increases in certain reserves of a life insurance company, the amount of the life insurance reserves for any contract (other than certain variable contracts) is the greater of (1) the net surrender value of the contract (if any), or (2) 92.87 percent of the amount determined using the tax reserve method otherwise applicable to the contract as of the date the reserve is determined. In the case of a variable contract, the amount of life insurance reserves for the contract is the sum of (1) the greater of (a) the net surrender value of the contract, or (b) the separate-account reserve amount under section 817 for the contract, plus (2) 92.87 percent of the excess (if any) of the amount determined using the tax reserve method otherwise applicable to the contract as of the date the reserve is determined over the amount determined in (1). In no event shall the reserves exceed the amount which would be taken into account in determining statutory reserves. No amount or item shall be taken into account more than once in determining any reserve. As under present law, no deduction for asset adequacy or deficiency reserves is allowed. The amount of life insurance reserves may not exceed the annual statement reserves. The provision provides reserve rules for supplemental benefits and retains present-law rules regarding certain contracts issued by foreign branches of domestic life insurance companies.

Effective date.—The proposal applies to taxable years beginning after December 31, 2017. For the first taxable year beginning after December 31, 2017, the difference in the amount of the reserve with respect to any contract at the end of the preceding taxable year and the amount of such reserve determined as if the proposal had applied for that year is taken into account for each of the eight taxable years following that preceding year, one-eighth per year.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment except that, instead of 92.87 percent, the percentage relating to the statutory reserve is 92.81 percent. More specifically, the provision provides that for purposes of determining the deduction for increases in certain reserves of a life insurance company, the amount of the life insurance reserves for any contract (other than certain variable contracts) is the greater of (1) the net surrender value of the contract (if any), or (2) 92.81 percent of the amount determined using the tax reserve method otherwise applicable to the contract as of the date the reserve is determined. In the case of a variable contract, the amount of life insurance reserves for the contract is the sum of (1) the greater of (a) the net surrender value of the contract, or (b) the separate-account reserve amount under section 817 for the contract, plus (2) 92.81 percent of the excess (if any) of the amount determined using the tax reserve method otherwise applicable to the contract as of the date the reserve is determined over the amount determined in (1). In no event shall the reserves exceed the amount which would be taken into account in determining statutory reserves. As under present law, no deduction for asset adequacy or deficiency reserves is allowed.

The amount of life insurance reserves may not exceed the annual statement reserves. A no-double-counting rule provides that no amount or item is taken into account more than once in determining any reserve under subchapter L of the Code. For example, an amount taken into account in determining a loss reserve under section 807 may not be taken into account again in determining a loss reserve under section 832. Similarly, a loss reserve determined under the tax reserve method (whether the Commissioners Reserve Valuation Method, the Commissioner's Annuity Reserve Valuation Method, a principles-based reserve method, or another method developed in the future, that is prescribed for a type of contract by the National Association of Insurance Commissioners) may not again be taken into account in determining the portion of the reserve that is separately accounted for under section 817 or be included also in determining the net surrender value of a contract.

The provision provides reserve rules for supplemental benefits and retains present-law rules regarding certain contracts issued by foreign branches of domestic life insurance companies. The provision requires the Secretary to provide for reporting (at such time and in such manner as the Secretary shall prescribe) with respect to the opening balance and closing balance or reserves and with respect to the method of computing reserves for purposes of determining income. For this purpose, the Secretary may require that a life insurance company (including an affiliated group filing a consolidated return that includes a life insurance company) is required to report each of the line item elements of each separate account by combining them with each such item from all other separate accounts and the general account, and to report the combined amounts on a line-by-line basis on the taxpayer's return. Similarly, the Secretary may in such guidance provide that reporting on a separate account by separate account basis is generally not permitted. Under existing regulatory authority, if the Secretary determines it is necessary in order to carry out and enforce this provision, the Secretary may require e-filing or comparable filing of the return on magnetic medial or other machine readable form, and may require that the taxpayer provide its annual statement via a link, electronic copy, or other similar means.

Effective date.—The provision applies to taxable years beginning after December 31, 2017. For the first taxable year beginning after December 31, 2017, the difference in the amount of the reserve with respect to any contract at the end of the preceding taxable year and the amount of such reserve determined as if the proposal had applied for that year is taken into account for each of the eight taxable years following that preceding year, one-eighth per year.

10. Modification of rules for life insurance proration for purposes of determining the dividends received deduction (sec. 13518 of the Senate amendment and sec. 812 of the Code)

PRESENT LAW

Reduction of reserve deduction and dividends received deduction to reflect untaxed income

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.[983]

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,[984] 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

[983] Secs. 807(a)(2)(B) and (b)(1)(B).

[984] Secs. 805(a)(4), 812.

insurance policies and annuity and endowment contracts.

Company's share and policyholder's share

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.[985] 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.[986]

Gross investment income includes specified items.[987] 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 and (b) a portion of policyholder dividends.[988] 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.[989]

In 2007, the IRS issued Rev. Rul. 2007–54,[990] 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.[991] No regulations have been issued to date.

General account and separate accounts

A variable contract is generally a life insurance (or annuity) contract whose death benefit (or annuity payout) depends explicitly on the investment return and market value of underlying assets.[992] The investment risk is generally that of the policyholder, not the insurer. The assets underlying variable contracts are maintained in separate accounts held by life insurers. These separate accounts are distinct from the insurer's general account in which it maintains assets supporting products other than variable contracts.

Reserves

For Federal income tax purposes, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves.[993] 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.

For purposes of determining the amount of the tax reserves for variable contracts, however, a special rule eliminates gains and losses. Under this rule,[994] in determining reserves for variable contracts, realized and unrealized gains are subtracted, and realized and unrealized losses are added, whether or not the assets have been disposed of. The basis of assets in the separate account is increased to reflect appreciation, and reduced to reflect depreciation in value, that are taken into account in computing reserves for such contracts.

Dividends received deduction

A corporate taxpayer may partially or fully deduct dividends received.[995] The percentage of the allowable dividends received deduction depends on the percentage of the stock of the distributing corporation that the recipient corporation owns.

Limitation on dividends received deduction under section 246(c)(4)

The dividends received deduction is not allowed with respect to stock either (1) held for 45 days or less during a 91-day period beginning 45 days before the ex-dividend date, or (2) to the extent the taxpayer is under an obligation to make related payments with respect to positions in substantially similar or related property.[996] The taxpayer's holding period is reduced for periods during which its risk of loss is reduced.[997]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision modifies the life insurance company proration rule for reducing dividends received deductions and reserve deductions with respect to untaxed income. For purposes of the life insurance proration rule of section 805(a)(4), the company's share is 70 percent. The policyholder's share is 30 percent.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

11. Capitalization of certain policy acquisition expenses (sec. 13519 of the Senate amendment and sec. 848 of the Code)

PRESENT LAW

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.[998]

A special rule provides for 60-month amortization of the first $5 million of specified policy acquisition expenses with a phase-out. The phase-out reduces the amount amortized over 60 months by the excess of the insurance company's specified policy acquisition expenses for the taxable year over $10 million.

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.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision extends the amortization period for specified policy acquisition expenses from a 120-month period to the 180-month period beginning with the first month in the second half of the taxable year. The provision does not change the special rule providing for 60-month amortization of the first $5 million of specified policy acquisition expenses (with phaseout). The provision provides that for annuity contracts, the percentage is 2.1 percent; for group life insurance contracts, the percentage is 2.46 percent; and for all other specified insurance contracts, the percentage is 9.24 percent.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with modifications. Under the conference agreement, the amortization period is 180 months. For annuity contracts, the percentage is 2.09 percent; for group life insurance contracts, the percentage is 2.45 percent; and for all other specified insurance contracts, the percentage is 9.20 percent.

2. Tax reporting for life settlement transactions, clarification of tax basis of life insurance contracts, and exception to transfer for valuable consideration rules (secs. 13518 through 13520 of the Senate amendment and secs. 101, 1016, and 6050X of the Code)

PRESENT LAW

An exclusion from Federal income tax is provided for amounts received under a life

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[985] Sec. 812(a).

[986] Sec. 812(c).

[987] Sec. 812(d).

[988] Sec. 812(b)(1). This portion is defined as gross investment income's share of policyholder dividends.

[989] 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, December 31, 1984, p. 622, stating, ''[u]nder the Act, the formula used for purposes of determining the policyholders' share is 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 200339049.

[990] 2007–38 I.R.B. 604.

[991] 2007–42 I.R.B. 799.

[992] Section 817(d) provides a more detailed definition of a variable contract.

[993] Sec. 807.

[994] Sec. 817.

[995] Sec. 243 *et seq.* Conceptually, dividends received by a corporation are retained in corporate solution; these amounts are taxed when distributed to noncorporate shareholders.

[996] Sec. 246(c).

[997] Sec. 246(c)(4). For this purpose, the holding period is reduced for periods in which (1) the taxpayer has an obligation to sell or has shorted substantially similar stock; (2) the taxpayer has granted an option to buy substantially similar stock; or (3) under Treasury regulations, the taxpayer has diminished its risk of loss by holding other positions with respect to substantially similar or related property.

[998] Sec. 848.

insurance contract paid by reason of the death of the insured.[999]

Under rules known as the transfer for value rules, if a life insurance contract is sold or otherwise transferred for valuable consideration, the amount paid by reason of the death of the insured that is excludable generally is limited.[1000] Under the limitation, the excludable amount may not exceed the sum of (1) the actual value of the consideration, and (2) the premiums or other amounts subsequently paid by the transferee of the contract. Thus, for example, if a person buys a life insurance contract, and the consideration he pays combined with his subsequent premium payments on the contract are less than the amount of the death benefit he later receives under the contract, then the difference is includable in the buyer's income.

Exceptions are provided to the limitation on the excludable amount. The limitation on the excludable amount does not apply if (1) the transferee's basis in the contract is determined in whole or in part by reference to the transferor's basis in the contract,[1001] or (2) the transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.[1002]

IRS guidance sets forth more details of the tax treatment of a life insurance policyholder who sells or surrenders the life insurance contract and the tax treatment of other sellers and of buyers of life insurance contracts. The guidance relates to the character of taxable amounts (ordinary or capital) and to the taxpayer's basis in the life insurance contract.

In Revenue Ruling 2009–13,[1003] the IRS ruled that income recognized under section 72(e) on surrender to the life insurance company of a life insurance contract with cash value is ordinary income. In the case of sale of a cash value life insurance contract, the IRS ruled that the insured's (seller's) basis is reduced by the cost of insurance, and the gain on sale of the contract is ordinary income to the extent of the amount that would be recognized as ordinary income if the contract were surrendered (the ''inside buildup''), and any excess is long-term capital gain. Gain on the sale of a term life insurance contract (without cash surrender value) is long-term capital gain under the ruling.

In Revenue Ruling 2009–14,[1004] the IRS ruled that under the transfer for value rules, a portion of the death benefit received by a buyer of a life insurance contract on the death of the insured is includable as ordinary income. The portion is the excess of the death benefit over the consideration and other amounts (e.g., premiums) paid for the contract. Upon sale of the contract by the purchaser of the contract, the gain is long-term capital gain, and in determining the gain, the basis of the contract is not reduced by the cost of insurance.

HOUSE BILL

No provision.

SENATE AMENDMENT

In general

The provision imposes reporting requirements in the case of the purchase of an existing life insurance contract in a reportable policy sale and imposes reporting requirements on the payor in the case of the payment of reportable death benefits. The provision sets forth rules for determining the basis of a life insurance or annuity contract. Lastly, the provision modifies the transfer for value rules in a transfer of an interest in a life insurance contract in a reportable policy sale.

Reporting requirements for acquisitions of life insurance contracts

Reporting upon acquisition of life insurance contract

The reporting requirement applies to every person who acquires a life insurance contract, or any interest in a life insurance contract, in a reportable policy sale during the taxable year. A reportable policy sale means the acquisition of an interest in a life insurance contract, directly or indirectly, if the acquirer has no substantial family, business, or financial relationship with the insured (apart from the acquirer's interest in the life insurance contract). An indirect acquisition includes the acquisition of an interest in a partnership, trust, or other entity that holds an interest in the life insurance contract.

Under the reporting requirement, the buyer reports information about the purchase to the IRS, to the insurance company that issued the contract, and to the seller. The information reported by the buyer about the purchase is (1) the buyer's name, address, and taxpayer identification number (''TIN''), (2) the name, address, and TIN of each recipient of payment in the reportable policy sale, (3) the date of the sale, (4) the name of the issuer, and (5) the amount of each payment. The statement the buyer provides to any issuer of a life insurance contract is not required to include the amount of the payment or payments for the purchase of the contract.

Reporting of seller's basis in the life insurance contract

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

Reporting with respect to reportable death benefits

When a reportable death benefit is paid under a life insurance contract, the payor insurance company is required to report information about the payment to the IRS and to the payee. Under this reporting requirement, the payor reports (1) the name, address and TIN of the person making the payment, (2) the name, address, and TIN of each recipient of a payment, (3) the date of each such payment, (4) the gross amount of the payment (5) the payor's estimate of the buyer's basis in the contract. A reportable death benefit means an amount paid by reason of the death of the insured under a life insurance contract that has been transferred in a reportable policy sale.

For purposes of these reporting requirements, a payment means the amount of cash and the fair market value of any consideration transferred in a reportable policy sale.

Determination of basis

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

Scope of transfer for value rules

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

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

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

I. Compensation[1005]

1. Modification of limitation on excessive employee remuneration (sec. 3801 of the House bill, sec. 13601 of the Senate amendment, 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[1006] is limited to no more than $1 million per year.[1007] The deduction limitation applies

[999] Sec. 101(a)(1). In the case of certain accelerated death benefits and viatical settlements, special rules treat certain amounts as amounts paid by reason of the death of an insured (that is, generally, excludable from income). Sec. 101(g). The rules relating to accelerated death benefits provide that amounts treated as paid by reason of the death of the insured include any amount received under a life insurance contract on the life of an insured who is a terminally ill individual, or who is a chronically ill individual (provided certain requirements are met). For this purpose, a terminally ill individual is one who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 24 months or less after the date of the certification. A chronically ill individual is one who has been certified by a licensed health care practitioner within the preceding 12-month period as meeting certain ability-related requirements. In the case of a viatical settlement, if any portion of the death benefit under a life insurance contract on the life of an insured who is terminally ill or chronically ill is sold to a viatical settlement provider, the amount paid for the sale or assignment of that portion is treated as an amount paid under the life insurance contract by reason of the death of the insured (that is, generally, excludable from income). For this purpose, a viatical settlement provider is a person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts on the lives of terminally ill or chronically ill individuals (provided certain requirements are met).

[1000] Sec. 101(a)(2).

[1001] Sec. 101(a)(2)(A).

[1002] Sec. 101(a)(2)(B).

[1003] 2009–21 I.R.B. 1029.

[1004] 2009–21 I.R.B. 1031.

[1005] Provisions relating to retirement plans are discussed in Part I.E.

[1006] 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).

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).[1008] Treasury regulations under section 162(m) provide that 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).[1009] 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[1010] 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.[1011]

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.[1012] 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 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.[1013]

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[1014]; (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'')[1015]; (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[1016]); 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,[1017] (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, provided 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.

HOUSE BILL

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,

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[1007] Sec. 162(m). This deduction limitation applies for purposes of the regular income tax and the alternative minimum tax.

[1008] Sec. 162(m)(3).

[1009] Notice 2007–49, 2007–25 I.R.B. 1429.

[1010] By reason of being among the officers whose total compensation is required to be reported to shareholders under the Securities Exchange Act of 1934.

[1011] Treas. Reg. sec. 1.162–27(c)(2).

[1012] Sec. 162(m)(2).

[1013] Sec. 162(m)(4)(F).

[1014] Sec. 162(m)(4)(B).

[1015] Sec. 162(m)(4)(C).

[1016] Secs. 105, 106, and 132.

[1017] 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.

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 is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment follows the House bill, except that it adds a transition rule for remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017 and which was not modified in any material respect on or after such date.

Effective date.—The provision applies to taxable years beginning after December 31, 2017. A transition rule applies to remuneration which is provided pursuant to a written binding contract which was in effect on November 2, 2017 and which was not modified in any material respect on or after such date.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment. For purposes of the transition rule, compensation paid pursuant to a plan qualifies for this exception provided that the right to participate in the plan is part of a written binding contract with the covered employee in effect on November 2, 2017. For example, suppose a covered employee was hired by XYZ Corporation on October 2, 2017 and one of the terms of the written employment contract is that the executive is eligible to participate in the 'XYZ Corporation Executive Deferred Compensation Plan' in accordance with the terms of the plan. Assume further that the terms of the plan provide for participation after 6 months of employment, amounts payable under the plan are not subject to discretion, and the corporation does not have the right to amend materially the plan or terminate the plan (except on a prospective basis before any services are performed with respect to the applicable period for which such compensation is to be paid). Provided that the other conditions of the binding contract exception are met (e.g., the plan itself is in writing), payments under the plan are grandfathered, even though the employee was not actually a participant in the plan on November 2, 2017.[1018]

The fact that a plan was in existence on November 2, 2017 is not by itself sufficient to qualify the plan for the exception for binding written contracts.

The exception for remuneration paid pursuant to a binding written contract ceases to apply to amounts paid after there has been a material modification to the terms of the contract. The exception does not apply to new contracts entered into or renewed after November 2, 2017. For purposes of this rule, any contract that is entered into on or before November 2, 2017 and that is renewed after such date is treated as a new contract entered into on the day the renewal takes effect. A contract that is terminable or cancelable unconditionally at will by either party to the contract without the consent of the other, or by both parties to the contract, is treated as a new contract entered into on the date any such termination or cancellation, if made, would be effective. However, a contract is not treated as so terminable or cancelable if it can be terminated or cancelled only by terminating the employment relationship of the covered employee.

[1018] As discussed in the text below, the grandfather ceases to apply if the plan is materially amended.

2. Excise tax on excess tax-exempt organization executive compensation (sec. 3802 of the House bill, sec. 13602 of the Senate amendment, and sec. 4960 of the Code)

PRESENT LAW

Taxable employers and other service recipients generally may deduct reasonable compensation expenses.[1019] 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.''[1020] 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).[1021]

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 parachute payment.''[1022] 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.[1023] 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.[1024] Certain amounts are not considered parachute payments, including payments under a qualified retirement plan, a simplified employee pension plan, or a simple retirement account.[1025]

These deduction limits generally do not affect a tax-exempt organization.

HOUSE BILL

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,[1026] a Federal, State or local governmental entity with excludable income,[1027] or a political organization.[1028]

Remuneration means wages as defined for income tax withholding purposes,[1029] but does not include any designated Roth contribution.[1030] 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[1031] during the taxable year with respect to the organization, (4) is a supporting organization[1032] during the taxable year with respect to the organization, or (5) in the case of a voluntary employees' beneficiary association (''VEBA''),[1033] 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,[1034] or an eligible deferred compensation plan of a State or local government employer.[1035]

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 is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except that remuneration is treated as paid when there is no substantial risk of forfeiture of the rights to such remuneration. In addition, the definition of remuneration for this purpose includes amounts

[1019] Sec. 162(a)(1).

[1020] Sec. 162(m)(1). Under section 162(m)(6), limits apply to deductions for compensation of individuals performing services for certain health insurance providers.

[1021] Notice 2007–49, 2007–2 I.R.B. 1429.

[1022] Sec. 280G(a) and (b)(1).

[1023] Sec. 280G(b)(2) and (c).

[1024] Sec. 280G(b)(3).

[1025] Secs. 401(a), 403(a), 408(k), and 408(p).

[1026] Sec. 521(b).

[1027] Sec. 115(1).

[1028] Sec. 527(e)(1).

[1029] Sec. 3401(a).

[1030] 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.

[1031] Sec. 509(f)(3).

[1032] Sec. 509(a)(3).

[1033] Sec. 501(c)(9).

[1034] Sec. 403(b).

[1035] Sec. 457(b).

required to be included in gross income under section 457(f).[1036]

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with modifications. Under the conference agreement, the tax rate is equal to corporate tax rate, which is 21 percent under the conference agreement. In addition, for purposes of the requirement to treat remuneration as paid when the rights to the remuneration are no longer subject to a substantial risk of forfeiture, the conference agreement clarifies that ''substantial risk of forfeiture'' is based on the definition under section 457(f)(3)(B) which applies to ineligible deferred compensation subject to section 457(f). Accordingly, the tax imposed by this provision can apply to the value of remuneration that is vested (and any increases in such value or vested remuneration) under this definition, even if it is not yet received.

The conference agreement exempts compensation paid to employees who are not highly compensated employees (within the meaning of section 414(q)) from the definition of parachute payment, and also exempts compensation attributable to medical services of certain qualified medical professionals from the definitions of remuneration and parachute payment. For purposes of determining a covered employee, remuneration paid to a licensed medical professional which is directly related to the performance of medical or veterinary services by such professional is not taken into account, whereas remuneration paid to such a professional in any other capacity is taken into account. A medical professional for this purpose includes a doctor, nurse, or veterinarian.

3. Treatment of qualified equity grants (sec. 3803 of the House bill, sec. 13603 of the Senate amendment, 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.[1037] 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.[1038] 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.[1039] 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 of the property.[1040] 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.[1041] 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.[1042]

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.[1043] 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.[1044]

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'').[1045] 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.[1046]

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.[1047] 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.[1048]

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'').[1049] 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

[1036] Sec. 457(f) applies to an ''ineligible'' deferred compensation plan of a State or local government or a tax-exempt employer (that is, a plan that does not meet the requirements to be an eligible plan under section 457(b)). Under an ineligible plan, deferred amounts are treated as nonqualified deferred compensation and includible in income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation. For this purpose, a person's rights to compensation are subject to a substantial risk of forfeiture if the rights are conditioned on the future performance of substantial services by any individual. Earnings post-vesting are generally taxed when paid.

[1037] 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.

[1038] 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.

[1039] See section 83(c)(1) and Treas. Reg. sec. 1.83–3(c) for the definition of substantial risk of forfeiture.

[1040] 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.

[1041] Sec. 83(h).

[1042] Treas. Reg. sec. 1.83–6.

[1043] 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.

[1044] Treas. Reg. sec. 1.83–6(a)(3).

[1045] 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.

[1046] Sec. 3121(v); Treas. Reg. sec. 31.3121(v)(2).

[1047] 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.

[1048] 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.

[1049] Sec. 3402. Specific withholding rates apply in the case of supplemental wages.

information for a calendar year, including taxable compensation, FICA wages, and withheld income and FICA taxes.[1050] In addition, information relating to certain non-taxable 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.[1051]

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'').[1052] 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.[1053] 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 capital 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.[1054] 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,[1055] 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[1056]), even if payment will not occur until a later year.[1057] 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.[1058] Nonqualified options are not automatically exempt from section 409A, but may be structured so as not to be considered nonqualified deferred compensation.[1059] 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 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.[1060]

HOUSE BILL

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;1A[1061] (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;[1062] (4) the date five 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.[1063]

An inclusion deferral election is made in a manner similar to the manner in which a section 83(b) election is made.[1064] 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.[1065] 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.[1066] 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 election, the employer's

[1050] Secs. 6041 and 6051.

[1051] 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.

[1052] 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.

[1053] 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.

[1054] Secs. 3121(a)(22), 3306(b)(19), and the last sentence of section 421(b).

[1055] 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.

[1056] Treas. Reg. sec. 1.409A–1(d).

[1057] 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 a potential interest factor tax (''409A taxes''). Section 409A and the additional 409A taxes apply to increases in the value of the failed compensation each year until it is paid.

[1058] Treas. Reg. sec. 1.409A–1(b)(6).

[1059] Treas. Reg. sec. 1.409A–1(b)(5). In addition, statutory option arrangements are not nonqualified deferred compensation arrangements.

[1060] Sec. 404(a)(5).

[1061] 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).

[1062] 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.

[1063] An inclusion deferral election is revoked at the time and in the manner as the Secretary provides.

[1064] Thus, as in the case of a section 83(b) election under present law, the employee must file with the IRS the inclusion deferral election and provide the employer with a copy.

[1065] This requirement is met if the stock purchased by the corporation includes all the corporation's outstanding deferral stock.

[1066] 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.

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,[1067] (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),[1068] or (4) who has been one of the four highest compensated officers of the corporation for any of the 10 preceding taxable years.[1069]

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,[1070] 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'').[1071] For 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.[1072] 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.[1073]

For purposes of the provision, corporations that are members of the same controlled group[1074] 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 tax rate applicable to individual taxpayers.[1075] 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except that, for purposes of determining corporations that are members of the same controlled group and treated as one corporation, the definition of controlled group under section 414(b) applies.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with modifications. The conference agreement clarifies that (1) when an inclusion deferral election is made with respect to stock transferred under an ESPP, the option is not considered an ESPP, such that when an inclusion deferral election is made in connection with the exercise of both ESPPs and ISOs, the options are not treated as statutory options but rather as nonqualified stock options for FICA purposes (in addition to being subject to section 83(i) for income tax purposes), (2) an excluded employee includes an individual who first becomes a 1 percent owner or one of the 4 highest compensated officers in a taxable year, notwithstanding that such individual may not have been among such categories for the 10 preceding taxable years, (3) the requirement that 80 percent of all applicable employees be granted stock options or restricted stock units with the same rights and privileges cannot be satisfied in a taxable year by granting a combination of stock options and RSUs, and instead all such employees must either be granted stock options or be granted restricted stock units for that year, and (4) the exception from treatment as a nonqualified deferred compensation plan for purposes of section 409A applies solely with respect to an employee who may receive qualified stock. It is intended that the requirement that 80 percent of all applicable employees be granted stock options or be granted restricted stock units apply consistently to eligible employees, whether they are new hires or existing employees. Additionally, it is intended that the limited circumstances outlined in section 83(c)(3) and applicable regulations apply with respect to the determination of when stock first becomes transferrable or is no longer subject to a substantial risk of forfeiture. For example, income inclusion cannot be delayed due to a lock-up period as a result of an initial public offering. Finally, it is intended that the transition rule provided with respect to compliance with the 80-percent and employer notice requirements not be expanded beyond these specific items.

[1067] One-percent owner status is determined under the top-heavy rules for qualified retirement plans, that is, section 416(i)(1)(B)(ii).

[1068] 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.

[1069] 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.

[1070] 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.

[1071] 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-time employee is defined under section 4980G(d)(4), as an employee who is customarily employed for fewer than 30 hours per week.

[1072] Sec. 423(b)(5).

[1073] 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.

[1074] As defined in sec. 1563(a).

[1075] 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.

4. Increase in excise tax rate for stock compensation of insiders in expatriated corporations (sec. 13604 of the Senate amendment and sec. 4985 of the Code)

PRESENT LAW

Income tax treatment of employee stock compensation

In general

Employers may grant various forms of stock compensation to employees,[1076] including nonstatutory and statutory stock options, restricted stock, restricted stock units, and stock appreciation rights. The tax treatment of these various forms of stock compensation depends on the specific terms and conditions of the arrangement and applicable rules.

Stock compensation treated as property transferred in connection with the performance of services

Section 83 generally governs the taxation of transfers of any property in connection with the performance of services by any service provider. Typically, this encompasses the transfer of stock to an employee which is subject to conditions that amount to a substantial risk of forfeiture, called ''restricted stock.'' Section 83 also generally governs the taxation of nonstatutory (or nonqualified) stock 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.[1077]

Generally, an employee 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).[1078]

These rules do not apply to the grant of a nonqualified option unless the option has a readily ascertainable fair market value.[1079] Instead, these rules generally 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.

Statutory stock 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'').[1080] Stock received pursuant to a statutory option is subject to special rules, rather than the rules for nonqualified options, discussed above. Unlike nonqualified options, statutory options may only be considered as such if granted to employees.[1081] No amount is includible in an employee's income on the grant, vesting, or exercise of a statutory option.

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 capital 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. 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.

Stock compensation treated as deferred compensation

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 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. An arrangement providing RSUs is generally considered a nonqualified deferred compensation plan and is subject to the rules, including the limits, of section 409A,[1082] unless it meets an exemption from section 409A. If the RSU either is exempt from or complies with section 409A, the employee is subject to income taxation on receipt of cash or the transfer of shares attributable to the RSU.

A stock appreciation right (''SAR'') is an arrangement under which an employee has the right to receive an amount (in the form of cash or stock) determined by reference to the appreciation in value of one or more shares of employer stock, based on the difference in the stock's value when the employee chooses to exercise the right and the value of the stock on the date of grant of the SAR. An SAR is generally taxable at the time of exercise on the amount of cash or value of stock transferred at the time of exercise of the SAR.[1083]

Various exemptions from section 409A apply, including transfers of property subject to section 83, such as restricted stock.[1084] Nonqualified options and SARs are not automatically exempt from section 409A, but may be structured so as not to be considered nonqualified deferred compensation.[1085] In addition, ISOs and ESPPs are exempt from section 409A.[1086]

Section 4985 excise tax on stock compensation of insiders of expatriated corporations

Under section 4985, certain holders of stock options and other stock-based compensation are subject to an excise tax upon certain transactions that result in an expatriated corporation[1087] (also referred to as corporate inversions).[1088] The provision imposes an excise tax, currently at the rate of 15 percent, on the value of specified stock compensation held (directly or indirectly) by or for the benefit of a disqualified individual, or a member of such individual's family, at any time during the 12-month period beginning six months before the corporation's expatriation date. Specified stock compensation is treated as held for the benefit of a disqualified individual if such compensation is held by an entity, *e.g.*, a partnership or trust, in which the individual, or a member of the individual's family, has an ownership interest.

A disqualified individual is any individual who, with respect to a corporation, is, at any time during the 12-month period beginning on the date which is six months before the expatriation date, subject to the requirements of section 16(a) of the Securities and Exchange Act of 1934 with respect to the corporation, or any member of the corporation's expanded affiliated group,[1089] or would be subject to such requirements if the corporation (or member) were an issuer of equity securities referred to in section 16(a). Disqualified individuals generally include officers (as defined by section 16(a)),[1090] directors, and 10-

[1076] The terms ''employer'' and ''employee'' are used, although the provision herein also applies to individuals who are not employees and the service recipients of such non-employee individuals.

[1077] See section 83(c)(1) and Treas. Reg. sec. 1.83–3(c) for the definition of substantial risk of forfeiture.

[1078] 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. 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).

[1079] 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.

[1080] 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.

[1081] Secs. 422(a)(2) and 423(a)(2).

[1082] Section 409A and the regulations thereunder provide rules for nonqualified deferred compensation. Unless an 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), even if payment will not occur until a later year. 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. Compensation that fails to meet the requirements of section 409A is also subject to an additional income tax of 20 percent on amounts includible in income and a potential interest factor tax (''409A taxes''). Section 409A and the additional 409A taxes apply to increases in the value of the failed compensation each year until it is paid.

[1083] Rev. Rul. 80–300, 1980–2 C.B. 165.

[1084] Treas. Reg. sec. 1.409A–1(b)(6).

[1085] Treas. Reg. sec. 1.409A–1(b)(5).

[1086] Treas. Reg. sec. 1.409A–1(b)(5)(ii).

[1087] Sec. 7874(a)(2).

[1088] For further discussion of the tax treatment of expatriated entities before the effective date of section 7874 and concerns that led to the enactment of sections 7874 and 4985, see Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in the 108th Congress* (JCS–5–05), May 2005.

[1089] An expanded affiliated group is an affiliated group (under section 1504) except that such group is determined without regard to the exceptions for certain corporations and is determined by substituting ''more than 50 percent'' for ''at least 80 percent.''

[1090] An officer is defined as the president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions.

percent owners of private and publicly-held corporations.

The excise tax is imposed on a disqualified individual of an expatriated corporation (as defined for this purpose) only if gain is recognized in whole or part by any shareholder by reason of the acquisition resulting in the corporate inversion.[1091]

Specified stock compensation subject to the excise tax includes any payment (or right to payment)[1092] granted by the expatriated corporation (or any member of the corporation's expanded affiliated group) to any person in connection with the performance of services by a disqualified individual for such corporation (or member of the corporation's expanded affiliated group) if the value of the payment or right is based on, or determined by reference to, the value or change in value of stock of such corporation (or any member of the corporation's expanded affiliated group). In determining whether such compensation exists and valuing such compensation, all restrictions, other than non-lapse restrictions, are ignored. Thus, the excise tax applies, and the value subject to the tax is determined, without regard to whether such specified stock compensation is subject to a substantial risk of forfeiture or is exercisable at the time of the corporate inversion. Specified stock compensation includes compensatory stock and restricted stock grants, compensatory stock options, and other forms of stock-based compensation, including stock appreciation rights, restricted stock units, phantom stock, and phantom stock options. Specified stock compensation also includes nonqualified deferred compensation that is treated as though it were invested in stock or stock options of the expatriating corporation (or member). For example, the provision applies to a disqualified individual's nonqualified deferred compensation if company stock is one of the actual or deemed investment options under the nonqualified deferred compensation plan.

Specified stock compensation includes a compensation arrangement that gives the disqualified individual an economic stake substantially similar to that of a corporate shareholder. A payment directly tied to the value of the stock is specified stock compensation.

The excise tax applies to any such specified stock compensation previously granted to a disqualified individual but cancelled or cashed-out within the six-month period ending with the expatriation date, and to any specified stock compensation awarded in the six-month period beginning with the expatriation date. As a result, for example, if a corporation cancels outstanding options three months before the transaction and then reissues comparable options three months after the transaction, the tax applies both to the cancelled options and the newly granted options.

Specified stock compensation subject to the tax does not include a statutory stock option or any payment or right from a qualified retirement plan or annuity, a tax-sheltered annuity, a simplified employee pension, or a simple retirement account. In addition, under the provision, the excise tax does not apply to any stock option that is exercised during the six-month period before the expatriation date or to any stock acquired pursuant to such exercise, if income is recognized under section 83 on or before the expatriation date with respect to the stock acquired pursuant to such exercise. The excise tax also does not apply to any specified stock compensation that is exercised, sold, exchanged, distributed, cashed out, or otherwise paid during such period in a transaction in which income, gain, or loss is recognized in full.

For specified stock compensation held on the expatriation date, the amount of the tax is determined based on the value of the compensation on such date. The tax imposed on specified stock compensation cancelled during the six-month period before the expatriation date is determined based on the value of the compensation on the day before such cancellation, while specified stock compensation granted after the expatriation date is valued on the date granted. Under the provision, the cancellation of a non-lapse restriction is treated as a grant.

The value of the specified stock compensation on which the excise tax is imposed is the fair value in the case of stock options (including warrants and other similar rights to acquire stock) and stock appreciation rights and the fair market value for all other forms of compensation. For purposes of the tax, the fair value of an option (or a warrant or other similar right to acquire stock) or a stock appreciation right is determined using an appropriate option-pricing model, as specified or permitted by the Treasury Secretary, that takes into account the stock price at the valuation date; the exercise price under the option; the remaining term of the option; the volatility of the underlying stock and the expected dividends on it; and the risk-free interest rate over the remaining term of the option. Options that have no intrinsic value (or ''spread'') because the exercise price under the option equals or exceeds the fair market value of the stock at valuation nevertheless have a fair value and are subject to tax under the provision. The value of other forms of compensation, such as phantom stock or restricted stock, is the fair market value of the stock as of the date of the expatriation transaction. The value of any deferred compensation that can be valued by reference to stock is the amount that the disqualified individual would receive if the plan were to distribute all such deferred compensation in a single sum on the date of the expatriation transaction (or the date of cancellation or grant, if applicable).

The excise tax also applies to any payment by the expatriated corporation or any member of the expanded affiliated group made to an individual, directly or indirectly, in respect of the tax. Whether a payment is made in respect of the tax is determined under all of the facts and circumstances. Any payment made to keep the individual in the same after-tax position that the individual would have been in had the tax not applied is a payment made in respect of the tax. This includes direct payments of the tax and payments to reimburse the individual for payment of the tax. Any payment made in respect of the tax is includible in the income of the individual, but is not deductible by the corporation.

To the extent that a disqualified individual is also a covered employee under section 162(m), the limit on the deduction allowed for employee remuneration for such employee is reduced by the amount of any payment (including reimbursements) made in respect of the tax under the provision. As discussed above, this includes direct payments of the tax and payments to reimburse the individual for payment of the tax.

The payment of the excise tax has no effect on the subsequent tax treatment of any specified stock compensation. Thus, the payment of the tax has no effect on the individual's basis in any specified stock compensation and no effect on the tax treatment for the individual at the time of exercise of an option or payment of any specified stock compensation, or at the time of any lapse or forfeiture of such specified stock compensation. The payment of the tax is not deductible and has no effect on any deduction that might be allowed at the time of any future exercise or payment.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision increases the 15 percent rate of excise tax, imposed on the value of stock compensation held by insiders of an expatriated corporation, to 20 percent.

Effective date.—The provision applies to corporations first becoming expatriated corporations after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

J. Other Provisions

1. Treatment of gain or loss of foreign persons from sale or exchange of interests in partnerships engaged in trade or business within the United States (sec. 13501 of the Senate amendment and secs. 864(c) and 1446 of the Code)

PRESENT LAW

In general

A partnership generally is not treated as a taxable entity, but rather, income of the partnership is taken into account on the tax returns of the partners. The character (as capital or ordinary) of partnership items passes through to the partners as if the items were realized directly by the partners.[1093] 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, and deducts its distributive share of partnership items of deduction and loss. A partner's basis in the partnership interest is increased by any amount of gain and decreased by ay amount of losses thus included. These basis adjustments prevent double taxation of partnership income to the partner. Money distributed to the partner by the partnership is taxed to the extent the amount exceeds the partner's basis in the partnership interest.

Gain or loss from the sale or exchange of a partnership interest generally is treated as gain or loss from the sale or exchange of a capital asset.[1094] However, the amount of money and the fair market value of property received in the exchange that represent the partner's share of certain ordinary income-producing assets of the partnership give rise to ordinary income rather than capital gain.[1095] In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election to do so,[1096] or the partnership has a substantial built-in loss immediately after the transfer.[1097] If an election is in effect or the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner. These adjustments are to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee partner's basis in its partnership interest.[1098] The effect of the adjustments on the basis of partnership property is

[1091] As referred to in section 7874(a)(2)(B)(i).

[1092] Under the provision, any transfer of property is treated as a payment and any right to a transfer of property is treated as a right to a payment.

[1093] Sec. 702.

[1094] Sec. 741; *Pollack v. Commissioner*, 69 T.C. 142 (1977).

[1095] Sec. 751(a). These ordinary income-producing assets are unrealized receivables of the partnership or inventory items of the partnership (''751 assets'').

[1096] Sec. 754.

[1097] Sec. 743(a).

[1098] Sec. 743(b).

to approximate the result of a direct purchase of the property by the transferee partner.

Source of gain or loss on transfer of a partnership interest

A foreign person that is engaged in a trade or business in the United States is taxed on income that is ''effectively connected'' with the conduct of that trade or business (''effectively connected gain or loss'').[1099] Partners in a partnership are treated as engaged in the conduct of a trade or business within the United States if the partnership is so engaged.[1100] 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.[1101]

Among the factors taken into account in determining whether income, gain, or loss is effectively connected gain or loss are the extent to which the income, gain, or loss is derived from assets used in or held for use in the conduct of the U.S. trade or business and whether the activities of the trade or business were a material factor in the realization of the income, gain, or loss (the ''asset use'' and ''business activities'' tests).[1102] In determining whether the asset use or business activities tests are met, due regard is given to whether such assets or such income, gain, or loss were accounted for through such trade or business. Thus, notwithstanding the general rule that source of gain or loss from the sale or exchange of personal property is generally determined by the residence of the seller,[1103] a foreign partner may have effectively connected income by reason of the asset use or business activities of the partnership in which he is an investor.

Special rules apply to treat gain or loss from disposition of U.S. real property interests as effectively connected with the conduct of a U.S. trade or business.[1104] To the extent that consideration received by the nonresident alien or foreign corporation for all or part of its interest in a partnership is attributable to a U.S. real property interest, that consideration is considered to be received from the sale or exchange in the United States of such property.[1105] In certain circumstances, gain attributable to sales of U.S. real property interests may be subject to withholding tax of ten percent of the amount realized on the transfer.[1106]

Under a 1991 revenue ruling, in determining the source of gain or loss from the sale or exchange of an interest in a foreign partnership, the IRS applied the asset-use test and business activities test at the partnership level to determine the extent to which income derived from the sale or exchange is effectively connected with that U.S. business. [1107] Under the ruling, if there is unrealized gain or loss in partnership assets that would be treated as effectively connected with the conduct of a U.S. trade or business if those assets were sold by the partnership, some or all of the foreign person's gain or loss from the sale or exchange of a partnership interest may be treated as effectively connected with the conduct of a U.S. trade or business. However, a 2017 Tax Court case rejects the logic of the ruling and instead holds that, generally, gain or loss on sale or exchange by a foreign person of an interest in a partnership that is engaged in a U.S. trade or business is foreign-source.[1108]

HOUSE BILL

No provision.

SENATE AMENDMENT

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

The provision also requires the transferee of a partnership interest to withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation. If the transferee fails to withhold the correct amount, the partnership is required to deduct and withhold from distributions to the transferee partner an amount equal to the amount the transferee failed to withhold.

The provision provides the Secretary of the Treasury with specific regulatory authority to address coordination with the nonrecognition provisions of the Code.

Effective date.—The provision is effective for sales and exchanges on or after November 27, 2017.

CONFERENCE AGREEMENT

The conference agreement generally follows the Senate amendment. The conference agreement modifies the grant of authority to the Secretary of the Treasury to make clear that the Secretary shall issues such regulations as the Secretary determines appropriate for the application of the paragraph, including in exchanges described in sections 332, 351, 354, 355, 356, or 361. The conference agreement also provides that the provisions related to withholding are effective for sales and exchanges after December 31, 2017. Additionally, the conferees intend that, under regulatory authority provided by the Senate amendment to carry out withholding requirements of the provision, the Secretary may provide guidance permitting a broker, as agent of the transferee, to deduct and withhold the tax equal to 10 percent of the amount realized on the disposition of a partnership interest to which the provision applies. For example, such guidance may provide that if an interest in a publicly traded partnership is sold by a foreign partner through a broker, the broker may deduct and withhold the 10-percent tax on behalf of the transferee.

Effective date.—The portion of the provision treating gain or loss on sale of a partnership interest as effectively connected income is effective for sales, exchanges, and dispositions on or after November 27, 2017. The portion of the provision requiring withholding on sales or exchanges of partnership interests is effective for sales, exchanges, and dispositions after December 31, 2017.

2. Modification of the definition of substantial built-in loss in the case of transfer of partnership interest (sec. 13502 of the Senate amendment and sec. 743 of the Code)

PRESENT LAW

In general, a partnership does not adjust the basis of partnership property following the transfer of a partnership interest unless either the partnership has made a one-time election under section 754 to make basis adjustments, or the partnership has a substantial built-in loss immediately after the transfer.[1109]

If an election is in effect, or if the partnership has a substantial built-in loss immediately after the transfer, adjustments are made with respect to the transferee partner. These adjustments are to account for the difference between the transferee partner's proportionate share of the adjusted basis of the partnership property and the transferee's basis in its partnership interest.[1110] The adjustments are intended to adjust the basis of partnership property to approximate the result of a direct purchase of the property by the transferee partner.

Under the provision, a substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property.[1111] Certain securitization partnerships and electing investment partnerships are not treated as having a substantial built-in loss in certain instances, and thus are not required to make basis adjustments to partnership property.[1112] For electing investment partnerships, in lieu of the partnership basis adjustments, a partner-level loss limitation rule applies.[1113]

HOUSE BILL

No provision.

SENATE AMENDMENT

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

For example, a partnership of three taxable partners (partners A, B, and C) has not made an election pursuant to section 754. The partnership has two assets, one of which, Asset X, has a built-in gain of $1 million, while the other asset, Asset Y, has a built-in loss of $900,000. Pursuant to the partnership agreement, any gain on sale or exchange of Asset X is specially allocated to partner A. The three partners share equally in all other partnership items, including in the built-in loss in Asset Y. In this case, each of partner B and partner C has a net built-in loss of $300,000 (one third of the loss attributable to asset Y) allocable to his partnership interest. Nevertheless, the partnership does not have an overall built-in loss, but a net built-in gain of $100,000 ($1 million minus $900,000). Partner C sells his partnership interest to another person, D, for $33,333. Under the provision, the test for a substantial built-in loss applies both at the partnership level and at

[1099] Secs. 871(b), 864(c), 882.

[1100] Sec. 875.

[1101] Secs. 871(b)(2), and 882(a)(2). 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 percent, and is collected by withholding at the source of the payment. The income of non-resident aliens or foreign corporations that is subject to tax at a rate of 30-percent is fixed, determinable, annual or periodical income that is not effectively connected with the conduct of a U.S. trade or business.

[1102] Sec. 864(c)(2).

[1103] Sec. 865(a).

[1104] Sec. 897(a), (g).

[1105] Sec. 897(g).

[1106] Sec. 1445(e)(5). Temp. Treas. Reg. sec. 1.1445–11T(b),(d).

[1107] Rev. Rul. 91–32, 1991–1 C.B. 107.

[1108] *See Grecian Magnesite Mining v. Commissioner*, 149 T.C. No. 3 (July 13, 2017).

[1109] Sec. 743(a).

[1110] Sec. 743(b).

[1111] Sec. 743(d).

[1112] See sec. 743(e) (alternative rules for electing investment partnerships) and sec. 743(f) (exception for securitization partnerships).

[1113] Unlike in the case of an electing investment partnership, the partner-level loss limitation rule does not apply for a securitization partnership.

the transferee partner level. If the partnership were to sell all its assets for cash at their fair market value immediately after the transfer to D, D would be allocated a loss of $300,000 (one third of the built-in loss of $900,000 in Asset Y). A substantial built-in loss exists under the partner-level test added by the provision, and the partnership adjusts the basis of its assets accordingly with respect to D.

Effective date.—The provision applies to transfers of partnership interests after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

Effective date.—The provision applies to transfers of partnership interests after December 31, 2017.

3. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss (sec. 13503 of the Senate amendment and sec. 704 of the Code)

PRESENT LAW

A partner's distributive share of partnership loss (including capital loss) is allowed only to the extent of the adjusted basis (before reduction by current year's losses) of the partner's interest in the partnership at the end of the partnership taxable year in which the loss occurred. Any disallowed loss is allowable as a deduction at the end of the first succeeding partnership taxable year, and subsequent taxable years, to the extent that the partner's adjusted basis for its partnership interest at the end of any such year exceeds zero (before reduction by the loss for the year).[1114]

A partner's basis in its partnership interest is increased by its distributive share of income (including tax exempt income). A partner's basis in its partnership interest is decreased (but not below zero) by distributions by the partnership and its distributive share of partnership losses and expenditures of the partnership not deductible in computing partnership taxable income and not properly chargeable to capital account.[1115] In the case of a charitable contribution, a partner's basis is reduced by the partner's distributive share of the adjusted basis of the contributed property.[1116]

A partnership computes its taxable income in the same manner as an individual with certain exceptions. The exceptions provide, in part, that the deductions for foreign taxes and charitable contributions are not allowed to the partnership.[1117] Instead, a partner takes into account its distributive share of the foreign taxes paid by the partnership and the charitable contributions made by the partnership for the taxable year.[1118]

However, in applying the basis limitation on partner losses, Treasury regulations do not take into account the partner's share of partnership charitable contributions and foreign taxes paid or accrued.[1119] The IRS has taken the position in a private letter ruling that the basis limitation on partner losses does not apply to limit the partner's deduction for its share of the partnership's charitable contributions.[1120] While the regulations relating to the loss limitation do not mention the foreign tax credit, a taxpayer may choose the foreign tax credit in lieu of deducting foreign taxes.[1121]

By contrast, under S corporation rules limiting the losses and deductions which may be taken into account by a shareholder of an S corporation to the shareholder's basis in stock and debt of the corporation, the shareholder's pro rata share of charitable contributions and foreign taxes are taken into account.[1122] In the case of charitable contributions, a special rule is provided prorating the amount of appreciation not subject to the limitation in the case of charitable contributions of appreciated property by the S corporation.[1123]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision modifies the basis limitation on partner losses to provide that the limitation takes into account a partner's distributive share of partnership charitable contributions (as defined in section 170(c)) and taxes (described in section 901) paid or accrued to foreign countries and to possessions of the United States. Thus, the amount of the basis limitation on partner losses is decreased to reflect these items. In the case of a charitable contribution by the partnership, the amount of the basis limitation on partner losses is decreased by the partner's distributive share of the adjusted basis of the contributed property. In the case of a charitable contribution by the partnership of property whose fair market value exceeds its adjusted basis, a special rule provides that the basis limitation on partner losses does not apply to the extent of the partner's distributive share of the excess.

Effective date.—The provision applies to partnership taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

Effective date.—The provision applies to partnership taxable years beginning after December 31, 2017.

4. Cost basis of specified securities determined without regard to identification (sec. 13533 of the Senate amendment and sec. 1012 of the Code)

PRESENT LAW

In general

Gain or loss generally is recognized for Federal income tax purposes on realization of that gain or loss (for example, as the result of sale of property). The taxpayer's gain or loss on a disposition of property is the difference between the amount realized on the sale and the taxpayer's adjusted basis in the property disposed of.[1124]

To compute adjusted basis, a taxpayer must first determine the property's unadjusted or original basis and then make adjustments prescribed by the Code.[1125] The original basis of property is its cost, except as otherwise prescribed by the Code (for example, in the case of property acquired by gift or bequest or in a tax-free exchange). Once determined, the taxpayer's original basis generally is adjusted downward to take account of depreciation or amortization, and generally is adjusted upward to reflect income and gain inclusions or capital improvements with respect to the property.

Basis computation rules

If a taxpayer has acquired stock in a corporation on different dates or at different prices and sells or transfers some of the shares of that stock, and the lot from which the stock is sold or transferred is not adequately identified, the shares sold are deemed to be drawn from the earliest acquired shares (the "first-in-first-out rule").[1126] However, if a taxpayer makes an adequate identification ("specific identification") of shares of stock that it sells, the shares of stock treated as sold are the shares that have been identified.[1127] A taxpayer who owns shares in a regulated investment company ("RIC") generally is permitted to elect, in lieu of the specific identification or first-in-first-out methods, to determine the basis of RIC shares sold under one of two average-cost-basis methods described in Treasury regulations (together, the "average basis method").[1128]

In the case of the sale, exchange, or other disposition of a specified security (defined below) to which the basis reporting requirement described below applies, the first-in-first-out rule, specific identification, and average basis method conventions are applied on an account by account basis.[1129] To facilitate the determination of the cost of RIC stock under the average basis method, RIC stock acquired before January 1, 2012, generally is treated as a separate account from RIC stock acquired on or after that date unless the RIC (or a broker holding the stock as a nominee) elects otherwise with respect to one or more of its stockholders, in which case all the RIC stock with respect to which the election is made is treated as a single account and the basis reporting requirement described below applies to all that stock.[1130]

The basis of stock acquired after December 31, 2010, in connection with a dividend reinvestment plan ("DRP") is determined under the average basis method for as long as the stock is held as part of that plan.[1131]

Basis reporting

A broker is required to report to the IRS a customer's adjusted basis in a covered security that the customer has sold and whether any gain or loss from the sale is long-term or short-term.[1132]

A covered security is, in general, any specified security acquired after an applicable date specified in the basis reporting rules. A specified security is any share of stock of a corporation (including stock of a RIC); any note, bond, debenture, or other evidence of

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[1114] Sec. 704(d) and Treas. Reg. sec. 1.704–1(d)(1).

[1115] Sec. 705(a).

[1116] Rev. Rul. 96–11, 1996–1 C. B. 140.

[1117] Sec. 703(a)(2)(B) and (C). In addition, section 703(a)(2) provides that other deductions are not allowed to the partnership, notwithstanding that the partnership's taxable income is computed in the same manner as an individual's taxable income, specifically: personal exemptions, net operating loss deductions, certain itemized deductions for individuals, or depletion.

[1118] Sec. 702.

[1119] The regulation provides that "[i]f the partner's distributive share of the aggregate of items of loss specified in section 702(a)(1), (2), (3), (8) [now (7)], and (9) [now (8)] exceeds the basis of the partner's interest computed under the preceding sentence, the limitation on losses under section 704(d) must be allocated to his distributive share of each such loss." The regulation does not refer to section 702(a)(4) (charitable contributions) and 702(a)(6) (foreign taxes paid or accrued). Treas. Reg. sec. 1.704–1(d)(2).

[1120] Priv. Ltr. Rul. 8405084. And see William S. McKee, William F. Nelson and Robert L. Whitmire, *Federal Taxation of Partnerships and Partners*, WG&L, 4th Edition (2011), paragraph 11.05[1][b], pp. 11–214 (noting that the "failure to include charitable contributions in the §704(d) limitation is an apparent technical flaw in the statute. Because of it, a zero-basis partner may reap the benefits of a partnership charitable contribution without an offsetting decrease in the basis of his interest, whereas a fellow partner who happens to have a positive basis may do so only at the cost of a basis decrease.").

[1121] Sec. 901.

[1122] Sec. 1366(d) and sec. 1366(a)(1). Under a related rule, the shareholder's basis in his interest is decreased by the basis (rather than the fair market value) of appreciated property by reason of a charitable contribution of the property by the S corporation (sec. 1367(a)(2)).

[1123] Sec. 1366(d)(4).

[1124] Sec. 1001.

[1125] Sec. 1016.

[1126] Treas. Reg. sec. 1.1012–1(c)(1).

[1127] Treas. Reg. sec. 1.1012–1(c)(2).

[1128] Treas. Reg. sec. 1.1012–1(e).

[1129] Sec. 1012(c)(1).

[1130] Sec. 1012(c)(2).

[1131] Sec. 1012(d)(1). Other special rules apply to DRP stock. See sec. 1012(d)(2) and (3).

[1132] Sec. 6045(g); Treas. Reg. sec. 1.6045–1(d).

derivative with respect to such commodity, if the Treasury Secretary determines that adjusted basis reporting is appropriate; and any other financial instrument with respect to which the Treasury Secretary determines that adjusted basis reporting is appropriate.

For purposes of satisfying the basis reporting requirements, a broker must determine a customer's adjusted basis in accordance with rules intended to ensure that the broker's reported adjusted basis numbers are the same numbers that customers must use in filing their tax returns.[1133]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision requires that the cost of any specified security sold, exchanged, or otherwise disposed of on or after January 1, 2018, be determined on a first-in first-out basis except to the extent the average basis method is otherwise allowed (as in the case of a taxpayer holding shares in a RIC). The provision does not apply to sales, exchanges, or other dispositions of specified securities by RICs.

The provision includes several conforming amendments, including a rule restricting a broker's basis reporting method to the first-in first-out method in the case of the sale of any stock for which the average basis method is not permitted.

Effective date.—The provision applies to sales, exchanges, and other dispositions after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

5. Expansion of qualifying beneficiaries of an electing small business trust (sec. 13541 of the Senate amendment and sec. 1361 of the Code)

PRESENT LAW

An electing small business trust (''ESBT'') may be a shareholder of an S corporation.[1134] Generally, the eligible beneficiaries of an ESBT include individuals, estates, and certain charitable organizations eligible to hold S corporation stock directly. A nonresident alien individual may not be a shareholder of an S corporation and may not be a potential current beneficiary of an ESBT.[1135]

The portion of an ESBT which consists of the stock of an S corporation is treated as a separate trust and generally is taxed on its share of the S corporation's income at the highest rate of tax imposed on individual taxpayers. This income (whether or not distributed by the ESBT) is not taxed to the beneficiaries of the ESBT.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment allows a nonresident alien individual to be a potential current beneficiary of an ESBT.

Effective date.—The provision takes effect on January 1, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

6. Charitable contribution deduction for electing small business trusts (sec. 13542 of the Senate amendment and sec. 642(c) of the Code)

PRESENT LAW

An electing small business trust (''ESBT'') may be a shareholder of an S corporation.[1136] The portion of an ESBT that consists of the stock of an S corporation is treated as a separate trust and generally is taxed on its share of the S corporation's income at the highest rate of tax imposed on individual taxpayers. This income (whether or not distributed by the ESBT) is not taxed to the beneficiaries of the ESBT. In addition to nonseparately computed income or loss, an S corporation reports to its shareholders their pro rata share of certain separately stated items of income, loss, deduction, and credit.[1137] For this purpose, charitable contributions (as defined in section 170(c)) of an S corporation are separately stated and taken by the shareholder.

The treatment of a charitable contribution passed through by an S corporation depends on the shareholder. Because an ESBT is a trust, the deduction for charitable contributions applicable to trusts,[1138] rather than the deduction applicable to individuals,[1139] applies to the trust. Generally, a trust is allowed a charitable contribution deduction for amounts of gross income, without limitation, which pursuant to the terms of the governing instrument are paid for a charitable purpose. No carryover of excess contributions is allowed. An individual is allowed a charitable contribution deduction limited to certain percentages of adjusted gross income generally with a five-year carryforward of amounts in excess of this limitation.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals apply to charitable contributions made by the portion of an ESBT holding S corporation stock.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

7. Production period for beer, wine, and distilled spirits (sec. 13801 of the Senate amendment and sec. 263A of the Code)

PRESENT LAW

In general

The uniform capitalization (''UNICAP'') rules, which were enacted as part of the Tax Reform Act of 1986,[1140] 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.[1141] 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.

In the case of interest expense, the UNICAP rules apply only to interest paid or incurred during the property's production period[1142] and that is allocable to property produced by the taxpayer or acquired for resale which (1) is either real property or property with a class life of at least 20 years, (2) has an estimated production period exceeding two years, or (3) has an estimated production period exceeding one year and a cost exceeding $1,000,000.[1143] The production period with respect to any property is the period beginning on the date on which production of the property begins, and ending on the date on which the property is ready to be placed in service or held for sale.[1144] In the case of property that is customarily aged (e.g., tobacco, wine, and whiskey) before it is sold, the production period includes the aging period.[1145]

Exceptions from UNICAP

Section 263A provides a number of exceptions to the general 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 for the preceding three-taxable year period;[1146] such taxpayers are not required to include additional section 263A costs in inventory.

Another exception exists for taxpayers who raise, harvest, or grow trees.[1147] 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 UNICAP rules do not apply to any animal or plant having a reproductive period of two years or less, 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)).[1148]

Freelance authors, photographers, and artists also are exempt from section 263A for any qualified creative expenses.[1149] 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.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment would exclude the aging periods for beer, wine, and distilled spirits from the production period for purposes of the UNICAP interest capitalization rules. Thus, under the provision, producers of beer, wine and distilled spirits are able to deduct interest expenses (subject to any other applicable limitation) attributable to a shorter production period.

The provision does not apply to interest costs paid or accrued after December 31, 2019.

[1133] See sec. 6045(g)(2).

[1134] Sec. 1361(c)(2)(A)(v).

[1135] Sec. 1361(b)(1)(C) and (c)(2)(B)(v).

[1136] Sec. 1361(c)(2)(A)(v).

[1137] Sec. 1366(a)(1).

[1138] Sec. 642(c).

[1139] Sec. 170.

[1140] Sec. 803(a) of Pub. L. No. 99–514 (1986).

[1141] Sec. 263A.

[1142] See Treas. Reg. sec. 1.263A–12.

[1143] Sec. 263A(f).

[1144] Sec. 263A(f)(4)(B).

[1145] See Treas. Reg. sec. 1.263A–12(d)(1). See also TAM 9327007 (Mar. 31, 1993) (holding that producers of wine must include the time that wine ages in bottles as part of the production period, which concludes when the wine vintage is officially released to the distribution chain).

[1146] Sec. 263A(b)(2)(B). No statutory exception is available for small taxpayers who produce property subject to section 263A. However, a *de minimis* rule under Treasury regulations treats producers that use the simplified production method and incur total indirect costs of $200,000 or less in a taxable year as having no additional indirect costs beyond those normally capitalized for financial accounting purposes. Treas. Reg. sec. 1.263A–2(b)(3)(iv). However, the Chairman's Mark of the ''Tax Cuts and Jobs Act'' proposes to expand the exception for small taxpayers from the uniform capitalization rules. Under the provision, any producer or reseller that meets the $15 million gross receipts test is exempted from the application of section 263A. See section III.B.4 of *Description of the Chairman's Mark of the ''Tax Cuts and Jobs Act''* (JCX–51–17), November 9, 2017.

[1147] Sec. 263A(c)(5).

[1148] Sec. 263A(d). See also section III.B.3 of *Description of the Chairman's Mark of the ''Tax Cuts and Jobs Act''* (JCX–51–17), November 9, 2017, which expands the universe of farming C corporations that may use the cash method to include any farming C corporation that meets the $15 million gross receipts test.

[1149] Sec. 263A(h).

Effective date.—The provision is effective for interest costs paid or accrued after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

8. Reduced rate of excise tax on beer (sec. 13802 of the Senate amendment and sec. 5051 of the Code)

PRESENT LAW

Federal excise taxes are imposed at different rates on distilled spirits, wine, and beer and are imposed on these products when produced or imported. Generally, these excise taxes are administered and enforced by the TTB, except the taxes on imported bottled distilled spirits, wine, and beer are collected by the Customs and Border Protection Bureau (the ''CBP'') of the Department of Homeland Security (under delegation by the Secretary of the Treasury).

Liability for the excise tax on beer also come into existence when the alcohol is produced but is not payable until the beer is removed from the brewery for consumption or sale. Generally, beer may be transferred between commonly owned breweries without payment of tax; however, tax liability follows these products. Imported bulk beer may be released from customs custody without payment of tax and transferred in bond to a brewery. Beer may be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

The rate of tax on beer is $18 per barrel (31 gallons).[1150] Small brewers are subject to a reduced tax rate of $7 per barrel on the first 60,000 barrels of beer domestically produced and removed each year.[1151] Small brewers are defined as brewers producing fewer than two million barrels of beer during a calendar year. The credit reduces the effective per-gallon tax rate from approximately 58 cents per gallon to approximately 22.6 cents per gallon for this beer.

In the case of a controlled group, the two million barrel limitation for small brewers is applied to the controlled group, and the 60,000 barrels eligible for the reduced rate of tax, are apportioned among the brewers who are component members of such group. The term ''controlled group'' has the meaning assigned to it by sec. 1563(a), except that the phrase ''more than 50 percent'' is substituted for the phrase ''at least 80 percent'' in each place it appears in sec. 1563(a).

Individuals may produce limited quantities of beer for personal or family use without payment of tax during each calendar year. The limit is 200 gallons per calendar year for households of two or more adults and 100 gallons per calendar year for single-adult households.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment lowers the rate of tax on beer to $16 per barrel on the first six million barrels brewed by the brewer or imported by the importer. In general, in the case of a controlled group of brewers, the six million barrel limitation is applied and apportioned at the level of the controlled group. Beer brewed or imported in excess of the six million barrel limit would continue to be taxed at $18 per barrel. In the case of small brewers, such brewers would be taxed at a rate of $3.50 per barrel on the first 60,000 barrels domestically produced, and $16 per barrel on any further barrels produced. The same rules applicable to controlled groups under present law apply with respect to this limitation.

For barrels of beer that have been brewed or produced outside of the United States and imported into the United States, the reduced tax rate may be assigned by the brewer to any importer of such barrels pursuant to requirements set forth by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services and the Secretary of the Department of Homeland Security. These requirements are to include: (1) a limitation to ensure that the number of barrels of beer for which the reduced tax rate has been assigned by a brewer to any importer does not exceed the number of barrels of beer brewed or produced by such brewer during the calendar year which were imported into the United States by such importer; (2) procedures that allow a brewer and an importer to elect whether to receive the reduced tax rate; (3) requirements that the brewer provide any information as the Secretary of the Treasury determines necessary and appropriate for purposes of assignment of the reduced tax rate; and (4) procedures that allow for revocation of eligibility of the brewer and the importer for the reduced tax rate in the case of erroneous or fraudulent information provided in (3) which the Secretary of the Treasury deems to be material for qualifying for the reduced tax rate.

Any importer making an election to receive the reduced tax rate shall be deemed to be a member of the controlled group of the brewer, within the meaning of sec. 1563(a), except that the phrase ''more than 50 percent'' is substituted for the phrase ''at least 80 percent'' in each place it appears in sec 1563(a).[1152]

Under rules issued by the Secretary of the Treasury, two or more entities (whether or not under common control) that produce beer marketed under a similar brand, license, franchise, or other arrangement shall be treated as a single taxpayer for purposes of the excise tax on beer.

The provision does not apply for beer removed after December 31, 2019.

Effective date.—The provision is effective for beer removed after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

9. Transfer of beer between bonded facilities (sec. 13803 of the Senate amendment and sec. 5414 of the Code)

PRESENT LAW

Federal excise taxes are imposed at different rates on distilled spirits, wine, and beer and are imposed on these products when produced or imported. Generally, these excise taxes are administered and enforced by the TTB, except the taxes on imported bottled distilled spirits, wine, and beer are collected by the Customs and Border Protection Bureau (the ''CBP'') of the Department of Homeland Security (under delegation by the Secretary of the Treasury). The rate of tax on beer is $18 per barrel (31 gallons).[1153]

Liability for the excise tax on beer also come into existence when the alcohol is produced but is not payable until the beer is removed from the brewery for consumption or sale. Generally, beer may be transferred between commonly owned breweries without payment of tax; however, tax liability follows these products. Imported bulk beer may be released from customs custody without payment of tax and transferred in bond to a brewery. Beer may be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

Small domestic brewers are subject to a reduced tax rate of $7 per barrel on the first 60,000 barrels of beer removed each year.[1154] Small brewers are defined as brewers producing fewer than two million barrels of beer during a calendar year. The credit reduces the effective per-gallon tax rate from approximately 58 cents per gallon to approximately 22.6 cents per gallon for this beer.

Individuals may produce limited quantities of beer for personal or family use without payment of tax during each calendar year. The limit is 200 gallons per calendar year for households of two or more adults and 100 gallons per calendar year for single-adult households.

Transfer rules and removals without tax

Certain removals or transfers of beer are exempt from tax. Beer may be transferred without payment of the tax between bonded premises under certain conditions specified in the regulations.[1155] The tax liability accompanies the beer that is transferred in bond. However, beer may only be transferred free of tax between breweries if both breweries are owned by the same brewer.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment relaxes the shared ownership requirement of section 5414. Thus, under the provision, a brewer may transfer beer from one brewery to another without incurring tax, provided that: (i) the breweries are owned by the same person; (ii) one brewery owns a controlling interest in the other; (iii) the same person or persons have a controlling interest in both breweries; or (iv) the proprietors of the transferring and receiving premises are independent of each other, and the transferor has divested itself of all interest in the beer so transferred, and the transferee has accepted responsibility for payment of the tax.

For purposes of transferring the tax liability pursuant to (iv) above, such relief from liability shall be effective from the time of removal from the transferor's bonded premises, or from the time of divestment, whichever is later.

The provision does not apply for calendar quarters beginning after December 31, 2019.

Effective date.—The provision applies to any calendar quarters beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

10. Reduced rate of excise tax on certain wine (sec. 13804 of the Senate amendment and sec. 5041 of the Code)

PRESENT LAW

In general

Under present law, excise taxes are imposed at different rates on wine, depending on the wine's alcohol content and carbonation levels. The following table outlines the present rates of tax on wine.

Tax (and Code Section)	Tax Rates
Wines (sec. 5041)	
''Still wines''[1156] not more than 14 percent alcohol.	$1.07 per wine gallon[1157]

[1150] Sec. 5051.

[1151] Sec. 5051(a)(2).

[1152] Members of the controlled group may include foreign corporations.

[1153] Sec. 5051.

[1154] Sec. 5051(a)(2).

[1155] Sec. 5414.

[1156] A ''still wine'' is a non-sparkling wine. Most common table wines are still wines.

[1157] A wine gallon is a U.S. liquid gallon.

Tax (and Code Section)	Tax Rates
"Still wines" more than 14 percent, but not more than 21 percent, alcohol.	$1.57 per wine gallon
"Still wines" more than 21 percent, but not more than 24 percent, alcohol.	$3.15 per wine gallon
"Still wines" more than 24 percent alcohol.	$13.50 per proof gallon (taxed as distilled spirits)
Champagne and other sparkling wines	$3.40 per wine gallon
Artificially carbonated wines	$3.30 per wine gallon

Liability for the excise taxes on wine come into existence when the wine is produced but is not payable until the wine is removed from the bonded wine cellar or winery for consumption or sale. Generally, bulk and bottled wine may be transferred in bond between bonded premises; however, tax liability follows these products. Bulk natural wine may be released from customs custody without payment of tax and transferred in bond to a winery. Wine may be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

Reduced rates and exemptions for certain wine producers

Wineries having aggregate annual production not exceeding 250,000 gallons (''small domestic producers'') receive a credit against the wine excise tax equal to 90 cents per gallon (the amount of a wine tax increase enacted in 1990) on the first 100,000 gallons of wine domestically produced and removed during a calendar year.[1158] The credit is reduced (but not below zero) by one percent for each 1,000 gallons produced in excess of 150,000 gallons; the credit does not apply to sparkling wines. In the case of a controlled group, the 250,000 gallon limitation for wineries is applied to the controlled group, and the 100,000 gallons eligible for the credit, are apportioned among the wineries who are component members of such group. The term ''controlled group'' has the meaning assigned to it by sec. 1563(a), except that the phrase ''more than 50 percent'' is substituted for the phrase ''at least 80 percent'' in each place it appears in sec 1563(a).

Individuals may produce limited quantities of wine for personal or family use without payment of tax during each calendar year. The limit is 200 gallons per calendar year for households of two or more adults and 100 gallons per calendar year for single-adult households.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment modifies the credit against the wine excise tax for small domestic producers, by removing the 250,000 wine gallon domestic production limitation (and thus making the credit available for all wine producers and importers). Additionally, under the provision, sparkling wine producers and importers are now eligible for the credit. With respect to wine produced in, or imported into, the United States during a calendar year, the credit amount is (1) $1.00 per wine gallon for the first 30,000 wine gallons of wine, plus; (2) 90 cents per wine gallon on the next 100,000 wine gallons of wine, plus; (3) 53.5 cents per wine gallon on the next 620,000 wine gallons of wine.[1159] There is no phaseout of the credit.

In the case of any wine gallons of wine that have been produced outside of the United States and imported into the United States, the tax credit allowable may be assigned by the person who produced such wine (the ''foreign producer'') to any electing importer of such wine gallons pursuant to requirements established by the Secretary of the Treasury, in consultation with the Secretary of Health and Human Services and the Secretary of the Department of Homeland Security. These requirement are to include: (1) a limitation to ensure that the number of wine gallons of wine for which the tax credit has been assigned by a foreign producer to any importer does not exceed the number of wine gallons of wine produced by such foreign producer, during the calendar year, which were imported into the United States by such importer; (2) procedures that allow the election of a foreign producer to assign, and an importer to receive, the tax credit; (3) requirements that the foreign producer provide any information that the Secretary of the Treasury determines to be necessary and appropriate for purposes of assigning the tax credit; and (4) procedures that allow for revocation of eligibility of the foreign producer and the importer for the tax credit in the case of erroneous or fraudulent information provided in (3) which the Secretary of the Treasury deems to be material for qualifying for the reduced tax rate.

Any importer making an election to receive the reduced tax rate shall be deemed to be a member of the controlled group of the winemaker, within the meaning of sec. 1563(a), except that the phrase ''more than 50 percent'' is substitute for the phrase ''at least 80 percent'' in each place it appears in sec 1563(a).[1160]

The provision does not apply for wine removed in calendar quarters beginning after December 31, 2019.

Effective date.—The provision applies to wine removed after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

11. Adjustment of alcohol content level for application of excise tax rates (sec. 13805 of the Senate amendment and sec. 5041 of the Code)

PRESENT LAW

In general

Under present law, excise taxes are imposed at different rates on wine, depending on the wine's alcohol content and carbonation levels. The following table outlines the present rates of tax on wine.

Tax (and Code Section)	Tax Rates
Wines (sec. 5041)	
"Still wines"[1161] not more than 14 percent alcohol.	$1.07 per wine gallon[1162]
"Still wines" more than 14 percent, but not more than 21 percent, alcohol.	$1.57 per wine gallon
"Still wines" more than 21 percent, but not more than 24 percent, alcohol.	$3.15 per wine gallon
"Still wines" more than 24 percent alcohol.	$13.50 per proof gallon (taxed as distilled spirits)
Champagne and other sparkling wines.	$3.40 per wine gallon
Artificially carbonated wines	$3.30 per wine gallon

Liability for the excise taxes on wine come into existence when the wine is produced but is not payable until the wine is removed from the bonded wine cellar or winery for consumption or sale. Generally, bulk and bottled wine may be transferred in bond between bonded premises; however, tax liability follows these products. Bulk natural wine may be released from customs custody without payment of tax and transferred in bond to a winery. Wine may be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

Reduced rates and exemptions for certain wine producers

Wineries having aggregate annual production not exceeding 250,000 gallons (''small domestic producers'') receive a credit against the wine excise tax equal to 90 cents per gallon (the amount of a wine tax increase enacted in 1990) on the first 100,000 gallons of wine domestically produced and removed during a calendar year.[1163] The credit is reduced (but not below zero) by one percent for each 1,000 gallons produced in excess of 150,000 gallons; the credit does not apply to sparkling wines. In the case of a controlled group, the 250,000 gallon limitation for wineries is applied to the controlled group, and the 100,000 gallons eligible for the credit, are apportioned among the wineries who are component members of such group. The term ''controlled group'' has the meaning assigned to it by sec. 1563(a), except that the phrase ''more than 50 percent'' is substituted for the phrase ''at least 80 percent'' in each place it appears in sec. 1563(a).

Individuals may produce limited quantities of wine for personal or family use without payment of tax during each calendar year. The limit is 200 gallons per calendar year for households of two or more adults and 100 gallons per calendar year for single-adult households.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment modifies alcohol-by-volume levels of the first two tiers of the excise tax on wine, by changing 14 percent to 16 percent. Thus, under the provision, a wine producer or importer may produce or import ''still wine'' that has an alcohol-by-volume level of up to 16 percent, and remain subject to the lowest rate of $1.07 per wine gallon.

The provision does not apply to wine removed after December 31, 2019.

Effective date.—The provision applies to wine removed after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

12. Definition of mead and low alcohol by volume wine (sec. 13806 of the Senate amendment and sec. 5041 of the Code)

PRESENT LAW

In general

Under present law, excise taxes are imposed at different rates on wine, depending on the wine's alcohol content and carbonation levels. The following table outlines the present rates of tax on wine.

Tax (and Code Section)	Tax Rates
Wines (sec. 5041)	
"Still wines"[1164] not more than 14 percent alcohol.	$1.07 per wine gallon[1165]
"Still wines" more than 14 percent, but not more than 21 percent, alcohol.	$1.57 per wine gallon
"Still wines" more than 21 percent, but not more than 24 percent, alcohol.	$3.15 per wine gallon

[1158] Sec. 5041(c).

[1159] The credit rate for hard cider is tiered at the same level of production or importation, but is equal to 6.2 cents, 5.6 cents and 3.3 cents, respectively.

[1160] Members of the controlled group may include foreign corporations.

[1161] A ''still wine'' is a non-sparkling wine. Most common table wines are still wines.

[1162] A wine gallon is a U.S. liquid gallon.

[1163] Sec. 5041(c).

[1164] A ''still wine'' is a non-sparkling wine. Most common table wines are still wines.

[1165] A wine gallon is a U.S. liquid gallon.

Tax (and Code Section)	Tax Rates
''Still wines'' more than 24 percent alcohol.	$13.50 per proof gallon (taxed as distilled spirits)
Champagne and other sparkling wines.	$3.40 per wine gallon
Artificially carbonated wines.	$3.30 per wine gallon

Liability for the excise taxes on wine come into existence when the wine is produced but is not payable until the wine is removed from the bonded wine cellar or winery for consumption or sale. Generally, bulk and bottled wine may be transferred in bond between bonded premises; however, tax liability follows these products. Bulk natural wine may be released from customs custody without payment of tax and transferred in bond to a winery. Wine may be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

Reduced rates and exemptions for certain wine producers

Wineries having aggregate annual production not exceeding 250,000 gallons (''small domestic producers'') receive a credit against the wine excise tax equal to 90 cents per gallon (the amount of a wine tax increase enacted in 1990) on the first 100,000 gallons of wine domestically produced and removed during a calendar year.[1166] The credit is reduced (but not below zero) by one percent for each 1,000 gallons produced in excess of 150,000 gallons; the credit does not apply to sparkling wines. In the case of a controlled group, the 250,000 gallon limitation for wineries is applied to the controlled group, and the 100,000 gallons eligible for the credit, are apportioned among the wineries who are component members of such group. The term ''controlled group'' has the meaning assigned to it by sec. 1563(a), except that the phrase ''more than 50 percent'' is substituted for the phrase ''at least 80 percent'' in each place it appears in sec 1563(a).

Individuals may produce limited quantities of wine for personal or family use without payment of tax during each calendar year. The limit is 200 gallons per calendar year for households of two or more adults and 100 gallons per calendar year for single-adult households.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment designates mead and certain sparkling wines to be taxed at the lowest rate applicable to ''still wine,'' of $1.07 per wine gallon of wine. Mead is defined as a wine that contains not more than 0.64 grams of carbon dioxide per hundred milliliters of wine,[1167] which is derived solely from honey and water, contains no fruit product or fruit flavoring, and contains less than 8.5 percent alcohol-by-volume. The sparkling wines eligible to be taxed at the lowest rate are those wines that contain not more than 0.64 grams of carbon dioxide per hundred milliliters of wine,[1168] which are derived primarily from grapes or grape juice concentrate and water, which contain no fruit flavoring other than grape, and which contain less than 8.5 percent alcohol by volume.

The provision does not apply to wine removed after December 31, 2019.

[1166] Sec. 5041(c).

[1167] The Secretary is authorized to prescribe tolerances to this limitation as may be reasonably necessary in good commercial practice.

[1168] The Secretary is authorized to prescribe tolerances to this limitation as may be reasonably necessary in good commercial practice.

Effective date.—The provision applies to wine removed after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

13. Reduced rate of excise tax on certain distilled spirits (sec. 13807 of the Senate amendment and sec. 5001 of the Code)

PRESENT LAW

An excise tax is imposed on all distilled spirits produced in, or imported into, the United States.[1169] The tax liability legally comes into existence the moment the alcohol is produced or imported but payment of the tax is not required until a subsequent withdrawal or removal from the distillery, or, in the case of an imported product, from customs custody or bond.[1170]

Distilled spirits are taxed at a rate of $13.50 per proof gallon.[1171] Liability for the excise tax on distilled spirits comes into existence when the alcohol is produced but is not determined and payable until bottled distilled spirits are removed from the bonded premises of the distilled spirits plant where they are produced. Generally, bulk distilled spirits may be transferred in bond between bonded premises; however, tax liability follows these products. Imported bulk distilled spirits may be released from customs custody without payment of tax and transferred in bond to a distillery. Distilled spirits be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

A portion of the revenues from the distilled spirits excise tax imposed on rum imported or brought into[1172] the United States (less certain administrative costs) is transferred (''covered over'') to Puerto Rico and the U.S. Virgin Islands.[1173] The amount covered over is $10.50 per proof gallon ($13.25 per proof gallon during the period from July 1, 1999, through December 31, 2016).

Eligible distilled spirits wholesale distributors and distillers receive an income tax credit for the average cost of carrying previously imposed excise tax on beverages stored in their warehouses.[1174]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment institutes a tiered rate for distilled spirits. The rate of tax is lowered to $2.70 per proof gallon on the first 100,000 proof gallons of distilled spirits, $13.34 for all proof gallons in excess of that amount but below 22,130,000 proof gallons, and $13.50 for amounts thereafter. The provision contains rules so as to prevent members of the same controlled group from receiving the lower rate on more than 100,000 proof gallons of distilled spirits. Importers of distilled spirits are eligible for the lower rates.

The provision does not apply to distilled spirits removed after December 31, 2019.

[1169] Secs. 5001.

[1170] Secs. 5006, 5043, and 5054. In general, proprietors of distilled spirit plants, proprietors of bonded wine cellars, brewers, and importers are liable for the tax.

[1171] A ''proof gallon'' is a U.S. liquid gallon of proof spirits, or the alcoholic equivalent thereof. Generally a proof gallon is a U.S. liquid gallon consisting of 50 percent alcohol. On lesser quantities, the tax is paid proportionately. Credits are allowed for wine content and flavors content of distilled spirits. Sec. 5010.

[1173] Sec. 7652.

[1172] Because Puerto Rico is inside U.S. customs territory, articles entering the United States from that commonwealth are ''brought into'' rather than ''imported into'' the U.S.

[1174] Sec. 5011. Section 5011 is administered and enforced by the IRS.

Effective date.—The provision applies to distilled spirits removed after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

14. Bulk distilled spirits (sec. 13808 of the Senate amendment and sec. 5212 of the Code)

PRESENT LAW

An excise tax is imposed on all distilled spirits produced in, or imported into, the United States.[1175] The tax liability legally comes into existence the moment the alcohol is produced or imported but payment of the tax is not required until a subsequent withdrawal or removal from the distillery, or, in the case of an imported product, from customs custody or bond.[1176]

Distilled spirits are taxed at a rate of $13.50 per proof gallon.[1177] Liability for the excise tax on distilled spirits comes into existence when the alcohol is produced but is not determined and payable until bottled distilled spirits are removed from the bonded premises of the distilled spirits plant where they are produced. Generally, bulk distilled spirits may be transferred in bond between bonded premises; however, tax liability follows these products. Additionally, in order to transfer such spirits in bond without payment of tax, such spirits may not be transferred in containers smaller than one gallon.[1178] Imported bulk distilled spirits may be released from customs custody without payment of tax and transferred in bond to a distillery. Distilled spirits be exported without payment of tax and may be withdrawn without payment of tax or free of tax from the production facility for certain authorized uses, including industrial uses and non-beverage uses.

A portion of the revenues from the distilled spirits excise tax imposed on rum imported or brought into[1179] the United States (less certain administrative costs) is transferred (''covered over'') to Puerto Rico and the U.S. Virgin Islands.[1180] The amount covered over is $10.50 per proof gallon ($13.25 per proof gallon during the period from July 1, 1999, through December 31, 2016).

Eligible distilled spirits wholesale distributors and distillers receive an income tax credit for the average cost of carrying previously imposed excise tax on beverages stored in their warehouses.[1181]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment allows distillers to transfer spirits in approved containers other than bulk containers in bond without payment of tax.

The provision does not apply to distilled spirits transferred in bond after December 31, 2019.

Effective date.—The provision applies to distilled spirits transferred in bond after December 31, 2017.

[1175] Secs. 5001.

[1176] Secs. 5006, 5043, and 5054. In general, proprietors of distilled spirit plants, proprietors of bonded wine cellars, brewers, and importers are liable for the tax.

[1177] A ''proof gallon'' is a U.S. liquid gallon of proof spirits, or the alcoholic equivalent thereof. Generally a proof gallon is a U.S. liquid gallon consisting of 50 percent alcohol. On lesser quantities, the tax is paid proportionately. Credits are allowed for wine content and flavors content of distilled spirits. Sec. 5010.

[1178] Sec. 5212.

[1179] Because Puerto Rico is inside U.S. customs territory, articles entering the United States from that commonwealth are ''brought into'' rather than ''imported into'' the U.S.

[1180] Sec. 7652.

[1181] Sec. 5011. Section 5011 is administered and enforced by the IRS.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

15. Modification of tax treatment of Alaska Native Corporations and Settlement Trusts (sec. 13821 of the Senate amendment and sec. 6039H and new secs. 139G and 247 of the Code)

PRESENT LAW

The Alaska Native Claims Settlement Act (''ANCSA'')[1182] established Native Corporations[1183] to hold property for Alaska Natives. Alaska Natives are generally the only permitted common shareholders of those corporations under section 7(h) of ANCSA, unless a Native Corporation specifically allows other shareholders under specified procedures.

ANCSA permits a Native Corporation to transfer money or other property to an Alaska Native Settlement Trust (''Settlement Trust'') for the benefit of beneficiaries who constitute all or a class of the shareholders of the Native Corporation, to promote the health, education and welfare of beneficiaries and to preserve the heritage and culture of Alaska Natives.[1184]

Native Corporations and Settlement Trusts, as well as their shareholders and beneficiaries, are generally subject to tax under the same rules and in the same manner as other taxpayers that are corporations, trusts, shareholders, or beneficiaries.

Special tax rules enacted in 2001 allow an election to use a more favorable tax regime for transfers of property by a Native Corporation to a Settlement Trust and for income taxation of the Settlement Trust. There is also simplified reporting to beneficiaries.

Under the special tax rules, a Settlement Trust may make an irrevocable election to pay tax on taxable income at the lowest rate specified for individuals, (rather than the highest rate that is generally applicable to trusts) and to pay tax on capital gains at a rate consistent with being subject to such lowest rate of tax. As described further below, beneficiaries may generally thereafter exclude from gross income distributions from a trust that has made this election. Also, contributions from a Native Corporation to an electing Settlement Trust generally will not result in the recognition of gross income by beneficiaries on account of the contribution. An electing Settlement Trust remains subject to generally applicable requirements for classification and taxation as a trust.

A Settlement Trust distribution is excludable from the gross income of beneficiaries to the extent of the taxable income of the Settlement Trust for the taxable year and all prior taxable years for which an election was in effect, decreased by income tax paid by the Trust, plus tax-exempt interest from State and local bonds for the same period. Amounts distributed in excess of the amount excludable is taxed to the beneficiaries as if distributed by the sponsoring Native Corporation in the year of distribution by the Trust, which means that the beneficiaries must include in gross income as dividends the amount of the distribution, up to the current and accumulated earnings and profits of the Native Corporation. Amounts distributed in excess of the current and accumulated earnings and profits are not included in gross income by the beneficiaries.

[1182] 43 U.S.C. 1601 *et seq.*

[1183] Defined at 43 U.S.C. 1602(m).

[1184] With certain exceptions, once an Alaska Native Corporation has made a conveyance to a Settlement Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgment, except with respect to the lawful debts and obligations of the Settlement Trust.

A special loss disallowance rule reduces (but not below zero) any loss that would otherwise be recognized upon disposition of stock of a sponsoring Native Corporation by a proportion, determined on a per share basis, of all contributions to all electing Settlement Trusts by the sponsoring Native Corporation. This rule prevents a stockholder from being able to take advantage of a decrease in value of a Native Corporation that is caused by a transfer of assets from the Native Corporation to a Settlement Trust.

The fiduciary of an electing Settlement Trust is obligated to provide certain information relating to distributions from the trust in lieu of reporting requirements under Section 6034A.

The election to pay tax at the lowest rate is not available in certain disqualifying cases where transfer restrictions have been modified to allow a transfer of either: (a) a beneficial interest that would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act if the interest were Settlement common stock, or (b) any stock in an Alaska Native Corporation that would not be permitted by section 7(h) if it were Settlement common stock and the Native Corporation thereafter makes a transfer to the Trust. Where an election is already in effect at the time of such disqualifying transfers, the special rules applicable to an electing trust cease to apply and rules generally applicable to trusts apply. In addition, the distributable net income of the trust is increased by undistributed current and accumulated earnings and profits of the trust, limited by the fair market value of trust assets at the date the trust becomes so disposable. The effect is to cause the trust to be taxed at regular trust rates on the amount of recomputed distributable net income not distributed to beneficiaries, and to cause the beneficiaries to be taxed on the amount of any distributions received consistent with the applicable tax rate bracket.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision comprises three separate but related sections. The first section allows a Native Corporation to assign certain payments described in ANCSA to a Settlement Trust without having to recognize gross income from those payments, provided the assignment is in writing and the Native Corporation has not received the payment prior to assignment. The Settlement Trust is required to include the assigned payment in gross income when received.

The second section allows a Native Corporation to elect annually to deduct contributions made to a Settlement Trust. If the contribution is in cash, the deduction is in the amount of cash contributed. If the contribution is property other than cash, the deduction is the amount of the Native Corporation's basis in the contributed property (or the fair market value of such property, if less than the Native Corporation's basis), and no gain or loss can be recognized on the contribution. The Native Corporation's deduction is limited to the amount of its taxable income for that year, and any unused deduction may be carried forward 15 additional years. The Native Corporation's earnings and profits for the taxable year are reduced by the amount of any deduction claimed for that year.

Generally, the Settlement Trust must include income equal to the deduction by the Native Corporation. For contributions of property other than cash, the Settlement Trust takes a basis in the property equal to its basis in the hands of the Native Corporation immediately before the contribution (or the fair market value of such property, if less than the Native Corporation's basis), and may elect to defer recognition of income associated with such property until the Settlement Trust sells or disposes of the property. In that case, any income that is deferred (i.e., the amount of income that would have been included upon contribution absent the election to defer) is treated as ordinary income, while any gain in excess of the amount that is deferred takes the same character as if the election had not been made. If property subject to this election is disposed of within the first taxable year subsequent to the taxable year in which the property was contributed to the Settlement Trust, the election is voided with respect to the property, and the Settlement Trust is required to pay any tax applicable to the disposition of the property, including interest, as well as a penalty of 10 percent of the amount of the tax. The provision provides for a four year assessment period in which to assess the tax, interest, and penalty amounts. The provision permits the amendment of the terms of any Settlement Trust agreement to allow this election within one year of the enactment of the provision, with certain restrictions.

The third section of the provision requires any Native Corporation which has made an election to deduct contributions to a Settlement Trust as described above to furnish a statement to the Settlement Trust containing: (1) the total amount of contributions; (2) whether such contribution was in cash; (3) for non-cash contributions, the date that such property was acquired by the Native Corporation and the adjusted basis of such property on the contribution date; (4) the date on which each contribution was made to the Settlement Trust; and (5) such information as the Secretary determines is necessary for the accurate reporting of income relating to such contributions.

Effective date.—The provision relating to the exclusion for ANCSA payments assigned to Settlement Trusts is effective to taxable years beginning after December 31, 2016.

The provision relating to the deduction of contributions is effective for taxable years for which the Native Corporation's refund statute of limitations period has not expired, and the provision provides a one-year waiver of the refund statute of limitations period in the event that the limitation period expires before the end of the one-year period beginning on the date of enactment.

The provision relating to the reporting requirement applies to taxable years beginning after December 31, 2016.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

16. Amounts paid for aircraft management services (sec. 13822 of the Senate amendment and sec. 4261 of the Code)

PRESENT LAW

Excise tax on taxable transportation by air

For domestic passenger transportation, section 4261 imposes an excise tax on amounts paid for taxable transportation. In general, for domestic flights, the tax consists of two parts: a 7.5 percent *ad valorem* tax applied to the amount paid and a flat dollar amount for each flight segment (consisting of one takeoff and one landing). ''Taxable transportation'' generally means transportation by air which begins and ends in the United States. The tax is paid by the person making the payment subject to tax and the tax is collected by the person receiving the payment. For commercial freight aviation, the *ad valorem* tax is 6.25 percent of the amount paid for transportation.

In determining whether a flight constitutes taxable transportation and whether the amounts paid for such transportation are subject to tax, the Internal Revenue Service (''IRS'') has looked at who has ''possession, command, and control'' of the aircraft based on the relevant facts and circumstances.[1185]

Applicability to aircraft management services

Generally, an aircraft management services company (''management company'') has as its business purpose the management of aircraft owned by other corporations or individuals (''aircraft owners''). In this function, management companies provide aircraft owners, among other things, with administrative and support services (such as scheduling, flight planning, and weather forecasting), aircraft maintenance services, the provision of pilots and crew, and compliance with regulatory standards. Although the arrangement between management companies and aircraft owners may vary, it is our understanding that aircraft owners generally pay management companies a monthly fee to cover the fixed expenses of maintaining the aircraft (such as insurance, maintenance, and recordkeeping) and a variable fee to cover the cost of using the aircraft (such as the provision of pilots, crew, and fuel).

In March 2012, the IRS issued a Chief Counsel Advice determining that a management company provided all of the essential elements necessary for providing transportation by air and the owner relinquished possession, command and control to the management company.[1186] Thus, the management company was determined to be providing taxable transportation to the owner and was required to collect the appropriate federal excise tax from the aircraft owner and remit it to the IRS. The Chief Counsel Advice resulted in increased audit activity by the IRS on aircraft management companies.

In May 2013, the IRS suspended assessment of the federal excise tax with respect to aircraft management services while it developed guidance on the tax treatment of aircraft management issues. In a 2015 opinion,[1187] an Ohio district court held that the existing revenue rulings (in effect for the tax period April 1, 2005, through June 30, 2009, the period that was the subject of the litigation) regarding the possession, command and control test, failed to provide precise and not speculative notice of a collection obligation as it related to whole-aircraft management contracts.[1188] As a result, the court ruled as a matter of law that because precise and not speculative notice was not received, the aircraft management company plaintiff did not have a collection obligation with respect to the Federal excise tax on payments received for whole-aircraft management services.

In 2017, the IRS decided not to pursue examination of the issue of whether amounts paid to aircraft companies by the owners or lessors of the aircraft are taxable until further guidance is made available. According to the IRS, for any exam in suspense the aircraft management fee issue was conceded and the taxpayers were notified accordingly.[1189] The IRS has not issued further guidance on this issue.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment exempts certain payments related to the management of private aircraft from the excise taxes imposed on taxable transportation by air. Exempt payments are those amounts paid by an aircraft owner for management services related to maintenance and support of the owner's aircraft or flights on the owner's aircraft. Applicable services include support activities related to the aircraft itself, such as its storage, maintenance, and fueling, and those related to its operation, such as the hiring and training of pilots and crew, as well as administrative services such as scheduling, flight planning, weather forecasting, obtaining insurance, and establishing and complying with safety standards. Aircraft management services also include such other services as are necessary to support flights operated by an aircraft owner.

Payments for flight services are exempt only to the extent that they are attributable to flights on an aircraft owner's own aircraft.[1190] Thus, if an aircraft owner makes a payment to a management company for the provision of a pilot and the pilot provides his services on the aircraft owner's aircraft, such payment is not subject to Federal excise tax. However, if the pilot provides his services to the aircraft owner on an aircraft other than the aircraft owner's (for instance, on an aircraft that is part of a fleet of aircraft available for third-party charter services), then such payment is subject to Federal excise tax.

The provision provides a pro rata allocation rule in the event that a monthly payment made to a management company is allocated in part to exempt services and flights on the aircraft owner's aircraft, and in part to flights on aircraft other than the aircraft owner's. In such a circumstance, Federal excise tax must be collected on that portion of the payment attributable to flights on aircraft not owned by the aircraft owner.

Under the provision, a lessee of an aircraft is considered an aircraft owner provided that the lease is not a ''disqualified lease.'' A disqualified lease is any lease of an aircraft from a management company (or a related party) for a term of 31 days or less.

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

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

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

17. Opportunity zones (sec. 13823 of the Senate amendment and new secs. 1400Z–1 and 1400Z–2 of the Code)

PRESENT LAW

The Code occasionally has provided several incentives aimed at encouraging economic growth and investment in distressed communities by providing Federal tax benefits to businesses located within designated boundaries.[1191]

One of these incentives is a federal income tax credit that is allowed in the aggregate amount of 39 percent of a taxpayer investment in a qualified community development entity (CDE).[1192] In general, the credit is allowed to a taxpayer who makes a ''qualified equity investment'' in a CDE which further invests in a ''qualified active low-income community business.'' CDEs are required to make investments in low income communities (generally communities with 20 percent or greater poverty rate or median family income less than 80 percent of statewide median). The credit is allowed over seven years, five percent in each of the first three years and six percent in each of the next four years. 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. The Department of Treasury's Community Development Financial Institutions Fund (''CDFI'') allocates the new markets tax credits.

The maximum annual amount of qualified equity investments is $3.5 billion for calendar years 2010 through 2019. The new markets tax credit is set to expire on December 31, 2019. No amount of unused allocation limitation may be carried to any calendar year after 2024.

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision provides for the temporary deferral of inclusion in gross income for capital gains reinvested in a qualified opportunity fund and the permanent exclusion of capital gains from the sale or exchange of an investment in the qualified opportunity fund.

The provision allows for the designation of certain low-income community population

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[1185] See, *e.g.*, Rev. Rul. 60–311, 1960–2 C.B. 341, which held that, since the company in question retains the elements of possession, command, and control of the aircraft and performs all services in connection with the operation of the aircraft, the company is, in fact, furnishing taxable transportation to the lessee; and the tax on the transportation of persons applies to the portion of the total payment which is allocable to the transportation of persons, provided such allocation is made on a fair and reasonable basis. If no allocation is made, the tax applies to the total payment for the lease of the aircraft.

[1186] CCA 2012–10026 (March, 2012).

[1187] *Netjets Large Aircraft Inc. v. United States*, 116 A.F.T.R. 2d. 2015–6776 (S.D. Ohio, 2015).

[1188] The district court held that such notice is required to persons having a deputy tax collection obligation under the rationale of the Supreme Court's holding in *Central Illinois Public Service Company v. United States*, 435 U.S. 21 (1978).

[1189] See also, Kerry Lynch, *IRS To Shelve Pending Audits on Aircraft Management Fees, AINonline (July 17, 2017)* http://www.ainonline.com/aviation-news/business-aviation/2017-07-17/irs-shelve-pending-audits-aircraft-management-fees.

[1190] Examples of arrangements that cannot qualify a person as an ''aircraft owner'' include ownership of stock in a commercial airline and participation in a fractional ownership aircraft program. Ownership of stock in a commercial airline cannot qualify an individual as an ''aircraft owner'' of a commercial airline's aircraft, and amounts paid for transportation on such flights remain subject to the tax under section 4261. Similarly, participation in a fractional ownership aircraft program does not constitute ''aircraft ownership'' for purposes of this standard. Amounts paid to a fractional ownership aircraft program for transportation under such a program are exempt from the ticket tax under section 4261(j) if the aircraft is operating under subpart K of part 91 of title 14 of the Code of Federal Regulations (''subpart K''), and flights under such program are subject to both the fuel tax levied on non-commercial aviation an additional fuel surtax under section 4043 of the Code. A business arrangement seeking to circumvent that surtax by operating outside of subpart K, allowing an aircraft owner the right to use any of a fleet of aircraft, be it through an aircraft interchange agreement, through holding nominal shares in a fleet of aircraft, or any other arrangement that does not reflect true tax ownership of the aircraft being flown upon, is not considered ownership for purposes of the provision.

[1191] Such designated areas were referred to as empowerment zones, the District of Columbia Enterprise (''DC'') Zone, and the Gulf Opportunity (''GO'') Zone, and each of these designations and attendant tax incentives have expired. The designations and tax incentives for the DC Zone, and the GO Zone generally expired after December 31, 2011. 1400(f), 1400N(h), 1400N(c)(5), 1400N(a)(2)(D), 1400N(a)(7)(C), 1400N(d). The empowerment zones program and attendant tax incentives expired as of December 31, 2016. Secs. 1391(d)(1), There are also areas that were designated as renewal communities under section 1400E which received tax benefits that all expired as of December 31, 2009, except that a zero-percent capital gains rate applies with respect to gain from the sale through December 31, 2014 of a qualified community asset acquired after December 31, 2001, and before January 1, 2010 and held for more than five years. For more information on these programs and attendant tax incentives, see Joint Committee on Taxation, *Incentives for Distressed Communities: Empowerment Zones and Renewal Communities* (JCX–38–09), October 5, 2009.

[1192] Sec. 45D.

census tracts as qualified opportunity zones, where low-income communities are defined in Section 45D(e). The designation of a population census tract as a qualified opportunity zone remains in effect for the period beginning on the date of the designation and ending at the close of the tenth calendar year beginning on or after the date of designation.

Governors may submit nominations for a limited number of opportunity zones to the Secretary for certification and designation. If the number of low-income communities in a State is less than 100, the Governor may designate up to 25 tracts, otherwise the Governor may designate tracts not exceeding 25 percent of the number of low-income communities in the State. Governors are required to provide particular consideration to areas that: (1) are currently the focus of mutually reinforcing state, local, or private economic development initiatives to attract investment and foster startup activity; (2) have demonstrated success in geographically targeted development programs such as promise zones, the new markets tax credit, empowerment zones, and renewal communities; and (3) have recently experienced significant layoffs due to business closures or relocations.

The provision provides two main tax incentives to encourage investment in qualified opportunity zones. First, it allows for the temporary deferral of inclusion in gross income for capital gains that are reinvested in a qualified opportunity fund. A qualified opportunity fund is an investment vehicle organized as a corporation or a partnership for the purpose of investing in qualified opportunity zone property (other than another qualified opportunity fund) that holds at least 90 percent of its assets in qualified opportunity zone property. The provision intends that the certification process for a qualified opportunity fund will be done in a manner similar to the process for allocating the new markets tax credit. The provision provides the Secretary authority to carry out the process.

If a qualified opportunity fund fails to meet the 90 percent requirement and unless the fund establishes reasonable cause, the fund is required to pay a monthly penalty of the excess of the amount equal to 90 percent of its aggregate assets, over the aggregate amount of qualified opportunity zone property held by the fund multiplied by the underpayment rate in the Code. If the fund is a partnership, the penalty is taken into account proportionately as part of each partner's distributive share.

Qualified opportunity zone property includes: any qualified opportunity zone stock, any qualified opportunity zone partnership interest, and any qualified opportunity zone business property.

The maximum amount of the deferred gain is equal to the amount invested in a qualified opportunity fund by the taxpayer during the 180-day period beginning on the date of sale of the asset to which the deferral pertains. For amounts of the capital gains that exceed the maximum deferral amount, the capital gains must be recognized and included in gross income as under present law.

If the investment in the qualified opportunity zone fund is held by the taxpayer for at least five years, the basis on the original gain is increased by 10 percent of the original gain. If the opportunity zone asset or investment is held by the taxpayer for at least seven years, the basis on the original gain is increased by an additional 5 percent of the original gain. The deferred gain is recognized on the earlier of the date on which the qualified opportunity zone investment is disposed of or December 31, 2026. Only taxpayers who rollover capital gains of non-zone assets before December 31, 2026, will be able to take advantage of the special treatment of capital gains for non-zone and zone realizations under the provision.

The basis of an investment in a qualified opportunity zone fund immediately after its acquisition is zero. If the investment is held by the taxpayer for at least five years, the basis on the investment is increased by 10 percent of the deferred gain. If the investment is held by the taxpayer for at least seven years, the basis on the investment is increased by an additional five percent of the deferred gain. If the investment is held by the taxpayer until at least December 31, 2026, the basis in the investment increases by the remaining 85 percent of the deferred gain.

The second main tax incentive in the bill excludes from gross income the post-acquisition capital gains on investments in opportunity zone funds that are held for at least 10 years. Specifically, in the case of the sale or exchange of an investment in a qualified opportunity zone fund held for more than 10 years, at the election of the taxpayer the basis of such investment in the hands of the taxpayer shall be the fair market value of the investment at the date of such sale or exchange. Taxpayers can continue to recognize losses associated with investments in qualified opportunity zone funds as under current law.

The Secretary or the Secretary's delegate is required to report annually to Congress on the opportunity zone incentives beginning 5 years after the date of enactment. The report is to include an assessment of investments held by the qualified opportunity fund nationally and at the State level. To the extent the information is available, the report is to include the number of qualified opportunity funds, the amount of assets held in qualified opportunity funds, the composition of qualified opportunity fund investments by asset class, and the percentage of qualified opportunity zone census tracts designated under the provision that have received qualified opportunity fund investments. The report is also to include an assessment of the impacts and outcomes of the investments in those areas on economic indicators including job creation, poverty reduction and new business starts, and other metrics as determined by the Secretary.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement generally follows the Senate amendment with the following modifications. First, the provision provides that each population census tract in each U.S. possession that is a low-income community is deemed certified and designated as a qualified opportunity zone effective on the date of enactment. Second, the provision clarifies that chief executive officer of the State (which includes the District of Columbia) may submit nominations for a limited number of opportunity zones to the Secretary for certification and designation. This change clarifies that the mayor of the District of Columbia may also submit nominations. Third, the provision clarifies that there is no gain deferral available with respect to any sale or exchange made after December 31, 2026, and there is no exclusion available for investments in qualified opportunity zones made after December 31, 2026. The agreement also makes some technical changes to the Senate amendment to make it clear which taxpayer may claim the tax benefits.

18. Provisions relating to the low-income housing credit (secs. 13411 and 13412 of the Senate amendment and sec. 42 of the Code)

PRESENT LAW

In general

The low-income housing credit may be claimed over a 10-year period for the cost of building rental housing a sufficient portion of which is rent restricted and occupied by tenants having incomes below specified levels.[1193] Qualified basis is the low-income portion of the building times the eligible basis. The amount of the credit for any taxable year in the credit period is the applicable percentage of the qualified basis of each qualified low-income building. The applicable percentage for new buildings that are not Federally subsidized, is computed to yield a present value of 70 percent of the qualified basis over a 10-year period. For other buildings the applicable percentage is calculated to yield 30 percent. Rehabilitation expenses are treated as a separate new building.

Increase in credit for certain high cost areas

In the case of a building located in a qualified census tract or difficult development area, the eligible basis of a building is 130 percent of eligible basis. This ‘‘basis boost also applies to rehabilitation expenditures that are treated as a separate new building.

A ‘‘difficult development area’’ is an area designated by the Secretary of Housing and Urban Development (‘‘HUD’’) as having high construction, land, and utility costs relative to the area's median income. The portions of metropolitan statistical areas that may be designated for this purpose cannot exceed an aggregate area having 20 percent of the population of such metropolitan statistical areas. A comparable rule applies to nonmetropolitan areas.

A ‘‘qualified census tract’’ means any census tract which is designated by HUD in which either: (1) 50 percent or more of the households have an income which is less than 60 percent of the area median income for the year; or (2) the poverty rate in that tract is 25 percent. The portion of a metropolitan statistical area that may be designated for this purpose cannot exceed an area having 20 percent of the population of such metropolitan statistical area. Each metropolitan statistical area is treated as a separate area and all nonmetropolitan areas in a State are treated as one area.

In addition, a building which is designated by a State housing credit agency as requiring an increase in credit to be financially feasible is treated as located in a HUD-designated difficult development area. This rule does not apply to a building if any portion of the eligible basis is financed with tax-exempt bonds.

General public use

In order to be eligible for the low-income housing credit, the residential units in a qualified low-income housing project must be available for use by the general public. A project is available for general public use if the project complies with housing non-discrimination policies including those set forth in the Fair Housing Act (42 U.S.C. sec. 3601) and (2) the project does not restrict occupancy based on membership in a social organization or employment by specific employers. In addition, any residential unit that is part of a hospital, nursing home, sanitarium, lifecare facility, trailer park, or intermediate care facility for the mentally or physically handicapped is not available for use by the general public.

However, a project that otherwise meets the general public use requirements above

[1193] Sec. 42.

shall not fail to meet the general public use requirement solely because of occupancy restrictions or preferences that favor tenants with (1) special needs; (2) who are members of a specified group under a Federal program or State program or policy that supports housing for such specified group; or (3) who are involved in artistic or literary activities.

HOUSE BILL

No provision.

SENATE AMENDMENT

Treatment of veterans' preference as not violating general public use requirements

The provision replaces the exception to the general public use requirement for tenants engaged in artistic and literary activities with an exception for veterans.

Increase in credit for certain rural housing

For buildings eligible for the 70 percent present-value credit, the provision makes two changes. First, the provision treats such buildings located in rural areas (as defined in section 520 of the Fair Housing Act of 1949) as located in a HUD-designated difficult development area. Second, the provision reduces the eligible basis for difficult to develop areas and qualified census tracts from 130 percent to 125 percent.[1194]

Effective date.—The provisions generally apply to buildings placed in service after the date of enactment. The changes related to the treatment of a veterans preference as not violating general public use requirements applies to buildings placed in service before, on, or after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not follow the Senate amendment provisions.

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 House 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.[1195]

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.[1196] 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.[1197] 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);[1198] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1199] and (3) certain State colleges and universities.[1200]

HOUSE BILL

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 organization 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

2. Exclusion of research income from unrelated business taxable income limited to publicly available research (sec. 5002 of the House 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.[1201] 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.[1202] 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);[1203] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1204] and (3) certain State colleges and universities.[1205]

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,[1206] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[1207] 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

[1194] A correction to the language is needed to conform to the intent that the change be limited to buildings eligible for the 70 percent credit only.

[1195] 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).

[1196] Secs. 511–514.

[1197] Treas. Reg. sec. 1.501(c)(3)–1(e).

[1198] Sec. 511(a)(2)(A).

[1199] Sec. 511(a)(2)(A).

[1200] Sec. 511(a)(2)(B).

[1201] Secs. 511–514.

[1202] Treas. Reg. sec. 1.501(c)(3)–1(e).

[1203] Sec. 511(a)(2)(A).

[1204] Sec. 511(a)(2)(A).

[1205] Sec. 511(a)(2)(B).

[1206] Secs. 511–514.

[1207] Sec. 512(b)(13).

example, income derived from research performed for the United States, a State, and certain agencies and subdivisions is excluded.[1208] Income from research performed by a college, university, or hospital for any person also is excluded.[1209] 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.[1210]

HOUSE BILL

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 income 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 provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

3. Unrelated business taxable income separately computed for each trade or business activity (sec. 13703 of the Senate amendment and sec. 512(a) 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

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.[1211]

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.[1212] 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.[1213] 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);[1214] (2) qualified pension, profit-sharing, and stock bonus plans described in section 401(a);[1215] and (3) certain State colleges and universities.[1216]

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,[1217] unless derived from debt-financed property or from certain 50-percent controlled subsidiaries.[1218] 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.

Specific deduction against unrelated business taxable income

In computing unrelated business taxable income, an exempt organization may take a specific deduction of $1,000. This specific deduction may not be used to create a net operating loss that will be carried back or forward to another year.[1219]

In the case of a diocese, province or religious order, or a convention or association of churches, a specific deduction is allowed with respect to each parish, individual church, district, or other local unit. The specific deduction is equal to the lower of $1,000 or the gross income derived from any unrelated trade or business regularly carried on by the local unit.[1220]

Operation of multiple unrelated trades or businesses

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.[1221] 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.[1222] As a result, an organization may use a deduction from one unrelated trade or business to offset income from another, thereby reducing total unrelated business taxable income.

HOUSE BILL

No provision.

SENATE AMENDMENT

For an organization with more than one unrelated trade or business, the provision requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction generally allowed under section 512(b)(12). The organization's unrelated business taxable income for a taxable year is the sum of the amounts (not less than zero) computed for each separate unrelated trade or business, less the specific deduction allowed under section 512(b)(12). A net operating loss deduction is allowed only with respect to a trade or business from which the loss arose.

The result of the provision is that a deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. The provision generally does not, however, prevent an organization from using a deduction from one taxable year to offset income from the same unrelated trade or business activity in another taxable year, where appropriate.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017. Under a special transition rule, net operating losses arising in a taxable year beginning before January 1, 2018, that are carried forward to a taxable year beginning on or after such date are not subject to the rule of the provision.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

B. Excise Taxes

1. Simplification of excise tax on private foundation investment income (sec. 5101 of the House 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[1223]) 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

[1208] Sec. 512(b)(7).

[1209] Sec. 512(b)(8).

[1210] Sec. 512(b)(9).

[1211] 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).

[1212] Secs. 511–514.

[1213] Treas. Reg. sec. 1.501(c)(3)–1(e).

[1214] Sec. 511(a)(2)(A).

[1215] Sec. 511(a)(2)(A).

[1216] Sec. 511(a)(2)(B).

[1217] Secs. 511–514.

[1218] Sec. 512(b)(13).

[1219] Sec. 512(b)(12).

[1220] Ibid.

[1221] Sec. 512(a).

[1222] Treas. Reg. sec. 1.512(a)–1(a).

[1223] 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).

paid to accomplish exempt purposes)[1224] 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.[1225] 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 to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[1226]

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

2. Private operating foundation requirements relating to operation of an art museum (sec. 5102 of the House 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.[1227] 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.[1228] 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.[1229] 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.[1230] 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.[1231]

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.[1232]

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.[1233] In general, a qualifying distribution is an amount paid to accomplish one or more of the organization's exempt purposes, including reasonable and necessary administrative expenses.[1234] 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.[1235] 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.[1236]

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.[1237] 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.[1238] 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.[1239]

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

[1224] Sec. 4942(g).

[1225] Sec. 4940(e).

[1226] Sec. 4942(d)(2).

[1227] The Code does not expressly define the term ''public charity,'' but rather provides exceptions to those entities that are treated as private foundations.

[1228] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[1229] 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).

[1230] 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).

[1231] 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.

[1232] 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.

[1233] Sec. 4942.

[1234] Sec. 4942(g)(1)(A).

[1235] Sec. 4942(a) and (b). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[1236] 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).

[1237] Sec. 4942(a)(1).

[1238] Sec. 4942(j)(3)(A); Treas. Reg. sec. 53.4942(b)–1(c).

[1239] Sec. 4942(j)(3)(B).

3. Excise tax based on investment income of private colleges and universities (sec. 5103 of the House bill, sec. 13701 of the Senate amendment, and new sec. 4968 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.[1240] 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.[1241] 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.[1242] 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.[1243] 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 the requirements of the Code, also is classified as a public charity.[1244]

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.[1245]

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)[1246] 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)[1247] 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.[1248] 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 to make to avoid tax under section 4942 is reduced by the amount of section 4940 excise taxes paid.[1249]

Private colleges and universities

Private colleges and universities generally are treated as public charities rather than private foundations[1250] and thus are not subject to the private foundation excise tax on net investment income.

HOUSE BILL

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;[1251] (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 preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose[1252]) 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[1253] or a supporting organization[1254] during the taxable year with respect to the institution.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

SENATE AMENDMENT

The Senate amendment follows the House bill with the following modifications. First, the definition of applicable educational institution is modified in two ways: (1) it requires that the educational institution have at least 500 *tuition paying* students; and (2) it increases the asset-per-student threshold from $250,000 to $500,000.

Second, the Senate amendment clarifies the operation of the related-party rules of the provision. For purposes of determining whether an educational institution meets the asset-per-student threshold and for purposes of determining net investment income, assets and net investment income of a related organization with respect to the educational institution are treated as assets and net investment income, respectively, of the educational institution, except that:

1. No such amount is taken into account with respect to more than one educational institution; and

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[1240] The Code does not expressly define the term "public charity," but rather provides exceptions to those entities that are treated as private foundations.

[1241] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[1242] 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).

[1243] 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).

[1244] 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.

[1245] 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.

[1246] 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).

[1247] Sec. 4942(g).

[1248] Sec. 4940(e).

[1249] Sec. 4942(d)(2).

[1250] Secs. 509(a)(1) and 170(b)(1)(A)(ii).

[1251] 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.

[1252] 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.

[1253] Secs. 509(f)(3).

[1254] Secs. 509(a)(3).

2. Unless the related organization is controlled by the educational institution or is a supporting organization (described in section 509(a)(3)) with respect to the institution for the taxable year, assets and investment income that are not intended or available for the use or benefit of the educational institution are not taken into account. For example, assets of a related organization that are earmarked or restricted for (or fairly attributable to) the educational institution would be treated as assets of the educational institution, whereas assets of a related organization that are held for unrelated purposes (and are not fairly attributable to the educational institution) would be disregarded.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with the following modification. The provision modifies the definition of ''applicable educational institution'' to include only institutions more than 50 percent of the tuition paying students of which are located in the United States. For this purpose, the number of students at a location 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.

It is intended that the Secretary promulgate regulations to carry out the intent of the provision, including regulations that describe: (1) assets that are used directly in carrying out the educational institution's exempt purpose; (2) the computation of net investment income; and (3) assets that are intended or available for the use or benefit of the educational 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 House 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.[1255] 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.[1256] 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.[1257] 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.[1258] 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.[1259]

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.[1260]

Excess business holdings of private foundations

Private foundations are subject to tax on excess business holdings.[1261] 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.[1262] This five-year period may be extended an additional five years in limited circumstances.[1263] 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.[1264]

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.

HOUSE BILL

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

[1255] The Code does not expressly define the term ''public charity,'' but rather provides exceptions to those entities that are treated as private foundations.

[1256] Sec. 509(a)(1) (referring to sections 170(b)(1)(A)(i) through (iv) for a description of these organizations).

[1257] 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).

[1258] 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).

[1259] 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.

[1260] 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.

[1261] Sec. 4943. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

[1262] Sec. 4943(c)(6).

[1263] Sec. 4943(c)(7).

[1264] Sec. 4943(d)(3).

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

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 House 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.[1265] 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.[1266] 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;[1267] (3) it may not be operated primarily to conduct an unrelated trade or business;[1268] (4) it may not engage in substantial 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.’’[1269] 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.[1270] 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.[1271] 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.’’[1272] 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,[1273] termination assessment of all taxes due,[1274] and an injunction against further political expenditures.[1275]

HOUSE BILL

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,[1276] gift,[1277] and estate tax[1278] purposes; and (3) application of the excise tax on political expenditures by section 501(c)(3) organizations.[1279]

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

2. Additional reporting requirements for donor advised fund sponsoring organizations (sec. 5202 of the House 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.[1280] Although sponsoring charities 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.[1281]

[1265] Treas. Reg. sec. 1.501(c)(3)–1(c)(1).

[1266] Treas. Reg. sec. 1.501(c)(3)–1(d)(2).

[1267] Treas. Reg. sec. 1.501(c)(3)–1(d)(1)(ii).

[1268] 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.

[1269] Sec. 509(a).

[1270] Secs. 4940–4945.

[1271] Sec. 501(c)(3).

[1272] Internal Revenue Code of 1954, sec. 501(c)(3), Pub. L. No. 591 (August 16, 1954).

[1273] Sec. 4955.

[1274] Sec. 6852(a)(1).

[1275] Sec. 7409.

[1276] Sec. 170(c)(2).

[1277] Sec. 2522.

[1278] Secs. 2055 and 2106.

[1279] Sec. 4955.

[1280] 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 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.

[1281] 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

A ''sponsoring organization'' is an organization that: (1) is described in section 170(c)[1282] (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[1283]); (2) is not a private foundation (as defined in section 509(a)); and (3) maintains one or more donor advised funds.[1284]

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.[1285] In addition, when seeking recognition of its tax-exempt status, a sponsoring organization must disclose whether it intends to maintain donor advised funds.[1286]

HOUSE BILL

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 taxable years beginning after December 31, 2017.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

INTERNATIONAL TAX PROVISIONS PRESENT LAW

The following discussion 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 in the bill.

A. General Overview of International Principles of Taxation

International law generally recognizes the right of each sovereign nation to prescribe rules to regulate conduct with a sufficient nexus to the sovereign nation. The nexus may be based on nationality of the actor, *i.e.*, a nexus between said conduct and a person (whether natural or juridical) with a connection to the sovereign nation, or it may be territorial, *i.e.*, a nexus between the conduct to be regulated and the territory where the conduct occurs.[1287] For example, most legal systems respect limits on the extent to which their measures may be given extraterritorial effect. The broad acceptance of such norms extends to authority to regulate cross-border trade and economic dealings, including taxation.

The exercise of sovereign jurisdiction is usually based on either nationality of the person whose conduct is regulated or the territory in which the conduct or activity occurs. These concepts have been refined and, in varying combinations, adapted to form the principles for determining whether sufficient nexus with a jurisdiction exists to conclude that the jurisdiction may enforce its right to impose a tax. The elements of nexus and the nomenclature of the principles may differ based on the type of tax in question. Taxes are categorized as either direct taxes or indirect taxes. The former category generally refers to those taxes that are imposed directly on a person (''capitation tax''), property, or income from property and that cannot be shifted to another person by the taxpayer. In contrast, indirect taxes are taxes on consumption or production of goods or services, for which a taxpayer may shift responsibility to another person. Such taxes include sales or use taxes, value-added taxes, or customs duties.[1288]

Although governments have imposed direct taxes on property and indirect taxes and duties on specific transactions since ancient times, the history of direct taxes in the form of an income tax is relatively recent.[1289] When determining how to allocate the right to tax a particular item of income, most jurisdictions consider principles based on either source (territory or situs of the income) or residence (nationality of the taxpayer).[1290] By contrast, when the authority to collect indirect taxes in the form of sales taxes or value added taxes is under consideration, jurisdictions analyze the taxing rights in terms of the origin principle or destination principle. The balance of this Part I.A describes the principles in more detail and how jurisdictions resolve claims of overlapping jurisdiction.

1. Origin and destination principles

Indirect taxes that are imposed based on the place where production of goods or services occur, irrespective of the location of the persons who own the means of production, and where the goods and services go after being produced, are examples of origin-based taxes. If, instead, authority to tax a transaction or service is dependent on the location of use or consumption of the goods or services, the tax system is an example of a destination-based tax. The most common form of a destination-based tax is the destination-based value-added tax (''VAT''). Over 160 countries have adopted a VAT,[1291] which is generally a tax imposed and collected on the ''value added'' at every stage in the production and distribution of a good or service. Although there are several ways to compute the taxable base for a VAT, the amount of value added can generally be thought of as the difference between the value of sales (outputs) and purchases (inputs) of a business.[1292] The United States does not have a VAT, nor is there a Federal sales or use tax. However, the majority of the States have enacted sales or use taxes, including both origin-based taxes and destination-based taxes.[1293]

With respect to cross-border transactions, the OECD has recommended that the destination principle be adopted for all indirect taxes, in part to conform to the treatment of such transactions for purposes of customs duties. The OECD defines the destination principle as ''the principle whereby, for consumption tax purposes, internationally traded services and intangibles should be taxed according to the rules of the jurisdiction of consumption.''[1294] A jurisdiction may determine the place of use or consumption by adopting the convention that the place of business or residence of a customer is the place of consumption. Use of such proxies are needed to determine the location of businesses that are juridical entities, which are more able than natural persons to move the location of use of goods, services or intangibles in response to imposition of tax.

2. Source and residence principles

Exercise of taxing authority based on a person's residence may be based on status as

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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).

[1282] Section 170(c) describes organizations to which charitable contributions that are deductible for income tax purposes can be made.

[1283] See sec. 170(c)(2)(A).

[1284] Sec. 4966(d)(1).

[1285] Sec. 6033(k).

[1286] Sec. 508(f).

[1287] American Law Institute, *Restatement (Third) of Foreign Relations Law of the United States*, secs. 402 and 403, (1987).

[1288] Maria S. Cox, Fritz Neumark, et al., ''Taxation'' *Encyclopedia Britannica*, https://www.britannica.com/topic/taxation/Classes-of-taxes, accessed May 16, 2017. Whether a tax is considered a direct tax or indirect tax has varied over time, and no single definition is used. For a review of the significance of these terms in Federal tax history, see Alan O. Dixler, ''Direct Taxes Under the Constitution: A Review of the Precedents,'' *Tax History Project, Tax Analysts*, available at *http://www.taxhistory.org/thp/readings.nsf/ArtWeb/2B34C7FBDA41D9DA8525730800067017?OpenDocument*, accessed May 17, 2017.

[1289] The earliest western income tax system is traceable to the British Tax Act of 1798, enacted in 1799 to raise funds needed to prosecute the Napoleonic Wars, and rescinded in 1816. See, A.M. Bardopoulos, *eCommerce and the Effects of Technology on Taxation*, Law, Governance and Technology Series 22, DOI 10.1007/978-3-319-15449-7_2, (Springer 2015), at Section 2.2. ''History of Tax,'' pp. 23–24. See also, *http://www.parliament.uk/about/living-heritage/transformingsociety/private-lives/taxation/overview/incometax/*.

[1290] Reuven Avi-Yonah, ''International Tax as International Law,'' 57 *Tax Law Review* 483 (2003–2004).

[1291] Alan Schenk, Victor Thuronyi, and Wei Cui, *Value Added Tax: A Comparative Approach*, Cambridge University Press, 2015. Consistent with the OECD *International VAT/GST Guidelines*, *supra*, the term VAT is used to refer to all broad-based final consumption taxes, regardless of the acronym used to identify. Thus, many countries that denominate their national consumption tax as a GST (general sales tax) are included in the estimate of the number of countries with a VAT.

[1292] Nearly all countries use the credit-invoice method of calculating value added to determine VAT liability. Under the credit-invoice method, a tax is imposed on the seller for all of its sales. The tax is calculated by applying the tax rate to the sales price of the good or service, and the amount of tax is generally disclosed on the sales invoice. A business credit is provided for all VAT levied on purchases of taxable goods and services (*i.e.*, ''inputs'') used in the seller's business. The ultimate consumer (*i.e.*, a non-business purchaser), however, does not receive a credit with respect to his or her purchases. The VAT credit for inputs prevents the imposition of multiple layers of tax with respect to the total final purchase price (*i.e.*, a ''cascading'' of the VAT). As a result, the net tax paid at a particular stage of production or distribution is based on the value added by that taxpayer at that stage of production or distribution. In theory, the total amount of tax paid with respect to a good or service from all levels of production and distribution should equal the sales price of the good or service to the ultimate consumer multiplied by the VAT rate.

In order to receive an input credit with respect to any purchase, a business purchaser is generally required to possess an invoice from a seller that contains the name of the purchaser and indicates the amount of tax collected by the seller on the sale of the input to the purchaser. At the end of a reporting period, a taxpayer may calculate its tax liability by subtracting the cumulative amount of tax stated on its purchase invoices from the cumulative amount of tax stated on its sales invoices.

[1293] EY, *Worldwide VAT, GST and Sales Tax Guide 2015*, p. 1021, available at *http://www.ey.com/Publication/ vwLUAssets/ Worldwide-VAT-GST- and-sales-tax-guide-2015/$FILE/Worldwide%20VAT,%20GST%20and%20Sales%20Tax%20 Guide%202015.pdf*.

[1294] See, OECD, ''Recommendation of the Council on the application of value added tax/goods and services tax to the international trade in services and intangibles as approved on September 27, 2016,'' [C(2016)120], appendix, page 3, reproduced in the appendix, OECD, *International VAT/GST Guidelines*, OECD Publishing, 2017.

a national, resident, or domiciliary of a jurisdiction and may reach worldwide activities of such persons. As such, it is the broadest assertion of taxing authority. For individuals, the test for residence may depend upon nationality, or a physical presence test, or some combination of the two. For all other persons, determining residency may require more complex consideration of the level of activities within a jurisdiction, management, control or place of incorporation. Such rules generally reflect a policy decision about the requisite level of activity within, or contact with, a jurisdiction by a person that is sufficient to warrant assertion of taxing jurisdiction.

Source-based exercise of taxing authority taxes income from activities that occur, or property that is located, within the territory of the taxing jurisdiction. If a person conducts business or owns property in a jurisdiction, or if a transaction occurs in whole or in part in a jurisdiction, the resulting taxation may require allocation and apportionment of expenses attributable to the activity in order to ensure that only the portion of profits that have the required nexus with the territory are subject to tax. Most jurisdictions, including the United States, have rules for determining the source of items of income and expense in a broad range of categories such as compensation for services, dividends, interest, royalties and gains.

Regardless of which of these two bases of taxing authority is chosen by a jurisdiction, a jurisdiction's determination of whether a transaction, activity or person is subject to tax requires that the jurisdiction establish the limits on its assertion of authority to tax.

3. Resolving overlapping or conflicting jurisdiction to tax

Countries have developed norms about what constitutes a reasonable regulatory action by a sovereign state that will be respected by other sovereign states. Consensus on what constitutes a reasonable limit on the extent of one state's jurisdiction helps to minimize the risk of conflicts arising as a result of extraterritorial action by a state or overlapping exercise of authority by states. Mechanisms to eliminate double taxation have developed to address those situations in which the source and residency determinations of the respective jurisdictions result in duplicative assertion of taxing authority. For example, asymmetry between different standards adopted in two countries for determining residency of persons, source of income, or other basis for taxation may result in income that is subject to taxation in both jurisdictions.

When the rules of two or more countries overlap, potential double taxation is usually mitigated by operation of bilateral tax treaties or by legislative measures permitting credit for taxes paid to another jurisdiction. The United States is a partner in numerous bilateral agreements that have as their objective the avoidance of international double taxation and the prevention of tax avoidance and evasion. Another related objective of U.S. tax treaties is the removal of the barriers to trade, capital flows, and commercial travel that may be caused by overlapping tax jurisdictions and by the burdens of complying with the tax laws of a jurisdiction when a person's contacts with, and income derived from, that jurisdiction are minimal. The United States Model Income Tax Convention (''U.S. Model Treaty of 2016'') with an accompanying Preamble by the Department of Treasury, reflects the most recent comprehensive statement of U.S. negotiating position with respect to tax treaties.[1295] Bilateral agreements are also used to permit limited mutual administrative assistance between jurisdictions.[1296]

In addition to entering into bilateral treaties, countries have worked in multilateral organizations to develop common principles to alleviate double taxation. Those principles are generally reflected in the provisions of the Model Tax Convention on Income and on Capital of the Organization for Economic Cooperation and Development (the ''OECD Model treaty''),[1297] a precursor of which was first developed by a predecessor organization in 1958, which in turn has antecedents from work by the League of Nations in the 1920s.[1298] As a consensus document, the OECD Model treaty is intended to serve as a model for countries to use in negotiating a bilateral treaty that would settle issues of double taxation as well as to avoid inappropriate double nontaxation. The provisions have developed over time as practice with actual bilateral treaties leads to unexpected results and new issues are raised by parties to the treaties.[1299]

4. International principles as applied in the U.S. system

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.

B. 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.

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.[1300] 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.[1301]

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.[1302] All other partnerships and corporations (that is, those organized under the laws of foreign countries) are treated as foreign.[1303] 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.[1304] 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, in which case it continues to be treated as a domestic corporation for ten years following such migration.[1305] 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

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[1295] The current U.S. Model treaty was published February 17, 2016, and is available at *https://www.treasury.gov/ resource-center/ tax-policy/ treaties/ Documents/Treaty-US%20Model-2016.pdf*; the Preamble is available at *https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Preamble-US%20Model-2016.pdf*. The U.S. Model treaty is updated periodically to reflect developments in the negotiating position of the United States. Such changes include provisions that were successfully included in bilateral treaties concluded by the United States, as well as new proposed measures not yet included in a bilateral agreement.

[1296] Although U.S. courts extend comity to foreign judgments in some instances, they are not required to recognize or assist in enforcement of foreign judgments for collection of taxes, consistent with the common law ''revenue rule'' in *Holman v. Johnson*, 1 Cowp. 341, 98 Eng. Rep. 1120 (K.B.1775). American Law Institute, *Restatement (Third) of Foreign Relations Law of the United States*, sec. 483, (1987). The rule retains vitality in U.S. case law. *Pasquantino v. United States*, 544 U.S. 349; 125 S. Ct. 1766; 161 L. Ed. 2d 619 (2005) (a conviction for criminal wire fraud arising from an intent to defraud Canadian tax authorities was found not to conflict ''with any well-established revenue rule principle[,]'' and thus was not in derogation of the revenue rule). To the extent it is abrogated, it is done so in bilateral treaties, to ensure reciprocity. At present, the United States has such agreements in force with five jurisdictions: Canada; Denmark; France; Netherlands; and Sweden.

[1297] OECD (2014), Model Tax Convention on Income and on Capital: Condensed Version 2014, OECD Publishing, 2014, available at *http://dx.doi.org/10.1787//mtc*__cond-2014-en. The multinational organization was first established in 1961 by the United States, Canada and 18 European countries, dedicated to global development, and has since expanded to 35 members.

[1298] ''Report by the Experts on Double Taxation,'' League of Nation Document E.F.S. (1923), a report commissioned by the League at its second assembly. See also, Lara Friedlander and Scott Wilkie, ''Policy Forum: The History of Tax Treaty Provisions—And Why It Is Important to Know About It,'' 54 *Canadian Tax Journal* No. 4 (2006).

[1299] For example, the OECD initiated a multi-year study on base-erosion and profit shifting in response to concerns of multiple members. For an overview of that project, see Joint Committee on Taxation, *Background, Summary, and Implications of the OECD/G20 Base Erosion and Profit Shifting Project* (JCX–139–15), November 30, 2015. This document can also be found on the Joint Committee on Taxation website at *www.jct.gov*.

[1300] Sec. 7701(a)(30).

[1301] Sec. 7701(b).

[1302] Sec. 7701(a)(4).

[1303] 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.

[1304] ''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).

[1305] Sec. 7874.

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.[1306]

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,[1307] 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 US-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.[1308]

In early 2017, Treasury issued final and temporary regulations[1309] that adopt, with few changes, the 2016 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.[1310] 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.[1311] 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 entity 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.[1312]

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.[1313] 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.[1314] Interest paid by the U.S. branch of a foreign corporation is also treated as U.S.-source income.[1315]

Dividends

Dividend income is generally sourced by reference to the payor's place of incorporation.[1316] 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.[1317]

Rents and royalties

Rental income is sourced by reference to the location or place of use of the leased property.[1318] The nationality or the country of residence 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.[1319] 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.[1320] 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,[1321] 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.[1322] As a result, nonresident includes any foreign corporation.[1323]

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.[1324] 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.[1325] 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.[1326]

1306 Section 7874(a). In addition, an excise tax may be imposed on certain stock compensation of executives of companies that undertake inversion transactions. Sec. 4985.

1307 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.

1308 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.

1309 T.D. 9812, January 13, 2017.

1310 Treas. Reg. sec. 301.7701–1, *et seq.*

1311 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.

1312 See, *e.g., Hunt v. Commissioner*, 90 T.C. 1289 (1988).

1313 Sec. 861(a)(1); Treas. Reg. sec. 1.861–2(a)(1).

1314 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).

1315 Sec. 884(f)(1).

1316 Secs. 861(a)(2), 862(a)(2).

1317 Sec. 861(a)(2)(B).

1318 Sec. 861(a)(4).

1319 *Ibid.*

1320 Sec. 865(a).

1321 Sec. 865(g)(1)(B).

1322 Sec. 865(g)(1)(A).

1323 Sec. 865(g).

1324 Secs. 865(b), 861(a)(6), 862(a)(6); Treas. Reg. sec. 1.861–7(c).

1325 Sec. 865(e)(2).

1326 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

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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 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.[1327]

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.[1328] 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.[1329]

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.[1330] Compensation for services performed both within and without the United States is allocated between U.S.-and foreign-source.[1331]

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.[1332]

Transportation income

Transportation income is any income derived from, or in connection with, the use (or hiring or leasing for use) of a vessel or aircraft (or a container used in connection therewith) or the performance of services directly related to such use.[1333] That definition does not encompass land transport except to the extent that it is directly related to shipping by vessel or aircraft, but regulations extend a similar rule for determining the source of income from transportation services other than shipping or aviation. Sources rules generally provide that income from furnishing transportation that both begins and ends in the United States is U.S.-source income,[1334] and 50-percent of income attributable to transportation that either begins or the ends in the United States is treated as U.S.-source income. However, to the extent that the operator of a shipping or cruise line is foreign, its ownership structure and the maritime law[1335] applicable for determining what constitutes international shipping as well as specific income tax provisions combine to create an industry-specific departure from the rules generally applicable.[1336]

A subcategory of transportation income, ''U.S. source gross transportation income'' is subject to taxation on a gross basis at the rate of four percent.[1337] Income is within the scope of this special tax if it is considered to be U.S. source because travel begins or ends in the United States, is not effectively connected, and is not of a kind to which the exemption from tax applies.[1338]

An exemption from U.S. tax is provided for transportation income of foreign persons from countries that extend reciprocal relief to U.S. persons. A nonresident alien individual with income from the international operation of a ship may qualify, provided that the foreign country in which such individual is resident grants an equivalent exemption to individual residents of the United States.[1339] A similar exemption from U.S. tax is provided for gross income derived by a foreign corporation from the international operation of an aircraft, provided that the foreign country in which the corporation is organized grants an equivalent exemption to corporations organized in the United States.[1340] To determine whether income from shipping or aviation is eligible for an exemption under section 883, one must examine the extent to which the foreign jurisdiction has extended reciprocity for U.S. businesses; whether the party claiming an exemption is eligible for the tax relief; and the nature of the activities that give rise to the income.

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.[1341] 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.[1342] 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.[1343] 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 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.[1344] 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

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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).

[1327] 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).

[1328] Sec. 865(c).

[1329] Sec. 865(d).

[1330] 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.

[1331] Treas. Reg. sec. 1.861–4(b).

[1332] Sec. 861(a)(7).

[1333] Sec. 863(c)(3).

[1334] Sec. 863(c).

[1335] 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.

[1336] 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.

[1337] Sec. 887(a). Special rules for determining whether transportation income is effectively connected with the conduct of a U.S. trade or business are also provided, and for coordinating the application of sections 871, 882, and 887.

[1338] Sec. 887(b)(1).

[1339] Sec. 872(b)(1).

[1340] Sec. 883(a)(2).

[1341] Sec. 863(d).

[1342] Sec. 863(e).

[1343] 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.

[1344] 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.

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[1345] 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.[1346] 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.[1347]

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.[1348] 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 trade or business is under consideration for cases with little potential for abuse and administrative difficulties.[1349]

C. 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[1350] or a bilateral income tax treaty.[1351]

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 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.[1352] 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.[1353] 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.[1354]

With respect to income from shipping, the gross basis tax potentially applicable is four percent,[1355] 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.[1356]

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.[1357] 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 more[1358] that are treated as income from U.S. sources are subject to gross-basis taxation.[1359] 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.[1360]

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.[1361] 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).[1362] Similarly, interest and original issue discount on certain short-term obligations is also exempt from U.S. tax when paid to a foreign person.[1363] Additionally, there is

[1345] 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.''

[1346] 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.

[1347] H.R. Rep. No. 99–426, p. 423.

[1348] Sec. 367(d).

[1349] 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).

[1350] *E.g.*, the portfolio interest exception in section 871(h) (discussed below).

[1351] 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.

[1352] Secs. 871(a), 881. If the FDAP income is also ECI, it is taxed on a net basis, at graduated rates.

[1353] 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.

[1354] Commissioner v. Wodehouse, 337 U.S. 369, 393 (1949).

[1355] Sec. 887.

[1356] 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.

[1357] 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).

[1358] 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).

[1359] 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'').

[1360] Secs. 871(a)(1)(D), 881(a)(4).

[1361] Secs. 871(i)(2)(A), 881(d); Treas. Reg. sec. 1.1441–1(b)(4)(ii).

[1362] Sec. 861(a)(1)(B); Treas. Reg. sec. 1.1441–1(b)(4)(iii).

[1363] Secs. 871(g)(1)(B), 881(a)(3); Treas. Reg. sec. 1.1441–1(b)(4)(iv).

generally no information reporting required with respect to payments of such amounts.[1364]

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.[1365] 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.[1366] Portfolio interest, however, does not include interest received by a 10-percent shareholder,[1367] certain contingent interest,[1368] interest received by a controlled foreign corporation from a related person,[1369] or interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business.[1370]

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.[1371] Withholding on FDAP payments to foreign payees is required unless the withholding agent,[1372] 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.[1373] The principal statutory exemptions from the 30-percent tax apply to interest on bank deposits, and portfolio interest, described above.[1374]

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.[1375] The nonresident withholding rules apply broadly to any financial institution or other payor, including foreign financial institutions.[1376]

To the extent that the withholding agent deducts and withholds an amount, the withheld tax is credited to the recipient of the income.[1377] 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.[1378] The excise tax is imposed on a 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.[1379] 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).[1380]

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.[1381] 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.[1382]

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.[1383]

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.

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.[1384] 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.[1385] Detailed rules govern whether trading in stocks or securities or commodities constitutes the conduct of a U.S. trade or business.[1386] 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

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[1364] 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.

[1365] Sec. 871(h)(2).

[1366] 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).

[1367] Sec. 871(h)(3).

[1368] Sec. 871(h)(4).

[1369] Sec. 881(c)(3)(C).

[1370] Sec. 881(c)(3)(A).

[1371] Secs. 1441, 1442.

[1372] 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).

[1373] Secs. 871, 881, 1441, 1442; Treas. Reg. sec. 1.1441–1(b).

[1374] 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 30-percent 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.

[1375] Treas. Reg. sec. 1.1461–1(b), (c).

[1376] See Treas. Reg. sec. 1.1441–7(a) (definition of withholding agent includes foreign persons).

[1377] Sec. 1462.

[1378] Secs. 4371–4374.

[1379] 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.

[1380] 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.

[1381] Secs. 871(b), 882.

[1382] Secs. 871(b)(2), 882(a)(2).

[1383] Sec. 875.

[1384] Sec. 864(b).

[1385] Sec. 864(b)(1).

[1386] Sec. 864(b)(2).

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.[1387]

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).[1388] 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.[1389]

A foreign person who is engaged in a U.S. trade or business may have limited categories of foreign-source income that are considered to be ECI.[1390] 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.[1391] 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.[1392]

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.[1393] 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.[1394]

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.[1395]

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.[1396] If, however, income or gain taken into account for a taxable year is attributable to the sale or exchange 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.[1397] 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.[1398]

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.[1399] 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;[1400] whether the party claiming an exemption is eligible for the tax relief;[1401] 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. Detailed 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.[1402] 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.[1403] 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.[1404]

Under the branch profits tax, the United States imposes a tax of 30 percent on a foreign corporation's ''dividend equivalent amount.''[1405] The dividend equivalent amount generally is the earnings and profits of a U.S. branch of a foreign corporation attributable to its ECI.[1406] Limited categories of earnings and profits attributable to a foreign corporation's ECI are excluded in calculating the dividend equivalent amount.[1407]

1387 Sec. 864(c).

1388 Sec. 864(c)(2).

1389 Sec. 864(c)(3).

1390 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.

1391 Sec. 864(c)(4)(B).

1392 Sec. 864(c)(4)(D)(i).

1393 Sec. 864(c)(5)(A).

1394 Sec. 864(c)(5)(B).

1395 Sec. 864(c)(4)(C).

1396 Sec. 864(c)(1)(B).

1397 Sec. 864(c)(6).

1398 Sec. 864(c)(7).

1399 Sec. 887(b)(4).

1400 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.

1401 Sec. 883(c) and regulations thereunder.

1402 Sec. 897(a).

1403 Sec. 1445 and Treasury regulations thereunder.

1404 See Treas. Reg. sec. 1.884–1(g), –5.

1405 Sec. 884(a).

1406 Sec. 884(b).

1407 See sec. 884(d)(2) (excluding, for example, earnings and profits attributable to gain from the sale of

Continued

In arriving at the dividend equivalent amount, a branch's effectively connected earnings and profits are adjusted to reflect 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).[1408] 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).[1409] 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.[1410] 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 that involve 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.[1411] Disqualified interest includes interest paid or accrued to related parties when no Federal income tax is imposed with respect to such interest;[1412] 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.

domestic corporation stock that constitutes a U.S. real property interest described in section 897.

1408 Sec. 884(b).

1409 Sec. 884(f)(1)(A).

1410 Sec. 884(f)(1)(B).

1411 Sec. 163(j).

1412 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).

D. 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,[1413] 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[1414] and the passive foreign investment company (''PFIC'') rules.[1415] 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.[1416]

2. Anti-deferral regimes

Subpart F

Subpart F,[1417] 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).[1418]

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.[1419] 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 other income that is readily movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income,[1420] insurance income,[1421] and certain income relating to international boycotts and other violations of public policy.[1422]

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.[1423]

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[1424] in order to address captive insurance companies.[1425] 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.[1426] 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.[1427] 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.[1428] 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 non-dividend 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, 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.[1429] 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).[1430]

1413 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.

1414 Secs. 951–964.

1415 Secs. 1291–1298.

1416 Secs. 901, 902, 960, 1293(f).

1417 Secs. 951–964.

1418 Secs. 951(b), 957, 958. The term ''United States shareholder'' is used interchangeably herein with ''U.S. shareholder.''

1419 Sec. 951(a).

1420 Sec. 954.

1421 Sec. 953.

1422 Sec. 952(a)(3)–(5).

1423 Sec. 954.

1424 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.

1425 Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS–10–87), May 4, 1987, p. 968.

1426 Secs. 951(a)(1)(B), 956.

1427 Sec. 956(c)(1).

1428 Sec. 956(c)(2).

1429 Sec. 954(c)(3).

1430 Sec. 954(b)(4).

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.[1431] 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.[1432]

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.[1433] 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 of section 475.[1434] 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.[1435] 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.[1436]

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.[1437] 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.[1438] 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.[1439]

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.[1440] 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.[1441]

Passive foreign investment companies

The Tax Reform Act of 1986[1442] 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.[1443] 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.[1444] 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.[1445] 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.''[1446]

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.[1447] 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 terms of the contracts, and the status of the company as an insurance company.[1448]

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[1449] 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.[1450]

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

[1431] Sec. 954(c)(6).

[1432] 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.

[1433] Sec. 954(h). See section 128 of the PATH Act of 2015, which made the active financing exception permanent.

[1434] Sec. 954(c)(2)(C).

[1435] Sec. 954(h)(3)(E).

[1436] 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.

[1437] Sec. 959(a)(1).

[1438] Sec. 959(a)(2).

[1439] Sec. 959(c).

[1440] Sec. 961(a).

[1441] Sec. 961(b).

[1442] Pub. L. No. 99–514.

[1443] Sec. 1297.

[1444] Secs. 1293–1295.

[1445] Sec. 1291.

[1446] Sec. 1296.

[1447] Sec. 1297(b)(2)(B).

[1448] 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.

[1449] Secs. 531–537.

[1450] Secs. 901, 902, 960, 1291(g).

serves its purpose of mitigating double taxation of foreign-source income without offsetting U.S. tax on U.S.-source income.[1451] 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.[1452]

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.[1453] However, subject to certain exceptions, deductions for interest expense and research and experimental expenses are apportioned based on taxpayer ratios.[1454] 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.[1455]

The term ''affiliated group'' is determined generally by reference to the rules for determining whether corporations are eligible to file consolidated returns.[1456] These rules exclude foreign corporations from an affiliated group.[1457] 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.[1458] The effective date of the modified rules has been delayed to January 1, 2021.[1459] 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.[1460] 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.[1461] Dividends received by a 10-percent corporate shareholder of a foreign corporation that is not a CFC are also categorized on a look-through basis.[1462]

Special rules apply to the allocation of income and losses from foreign and U.S. sources within each category of income.[1463] 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.[1464]

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.[1465]

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'').[1466] 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.[1467] 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.[1468]

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.[1469]

No foreign tax credit (or deduction) was allowed for foreign taxes attributable to the deductible portion of any dividend.[1470] 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).[1471] Deductions were disallowed for

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1451 Secs. 901, 904.

1452 Sec. 904(c).

1453 Treas. Reg. sec. 1.861–8(b), Temp. Treas. Reg. sec. 1.861–8T(c).

1454 Temp. Treas. Reg. sec. 1.861–9T, Treas. Reg. sec. 1.861–17.

1455 Sec. 864(e)(1), (6); Temp. Treas. Reg. sec. 1.861–14T(e)(2).

1456 Secs. 864(e)(5), 1504.

1457 Sec. 1504(b)(3).

1458 Sec. 864(f); ''American Jobs Creation Act of 2004'' (''AJCA''), Pub. L. 108–357, sec. 401(a).

1459 Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, sec. 551(a).

1460 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).

1461 Sec. 904(d)(3). The subpart F rules applicable to CFCs and their 10-percent U.S. shareholders are described below.

1462 Sec. 904(d)(4).

1463 Secs. 904(f), (g).

1464 Secs. 904(f)(1), (g)(1).

1465 Sec. 909.

1466 Sec. 1503(d).

1467 Treas. Reg. sec. 1.1503(d)–6(d).

1468 See Treas. Reg. sec. 1.1503(d)–6(e)(1).

1469 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.

1470 Sec. 965(d)(1).

1471 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).

expenses that were directly allocable to the deductible portion of any dividend.[1472]

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 be taxed as a DISC.[1473] In general, a DISC is not subject to corporate-level tax and offers limited deferral of tax liability to its shareholders.[1474] 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.[1475] 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.[1476] Gain on the sale of DISC stock is treated as a dividend to the extent of accumulated DISC income.[1477] 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.

INTERNATIONAL TAX PROVISIONS

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 House bill, sec. 14101 of the Senate amendment, and new sec. 245A of the Code)

HOUSE BILL

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'').[1478]

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.[1479] 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[1480] 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 connected 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.[1481] 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.

SENATE AMENDMENT

In general

The provision allows an exemption for certain 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)[1482] (referred to here as ''DRD'').

A specified 10-percent owned foreign corporation is any foreign corporation (other than a PFIC that is not also a CFC) with respect to which any domestic corporation is a U.S. shareholder.[1483]

Foreign-source portion of a dividend

The DRD is available only for the foreign-source portion of dividends received by a domestic corporation from specified 10-percent

[1472] Sec. 965(d)(2).

[1473] 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).

[1474] 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).

[1475] 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).

[1476] 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).

[1477] Sec. 995(c).

[1478] 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.

[1479] 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.

[1480] Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.

[1481] 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.

[1482] 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.

[1483] Secs. 1297, 1298.

owned foreign corporations. The foreign-source portion of any dividend is the amount that bears the same ratio to the dividend as the undistributed foreign earnings bears to the total undistributed earnings of the foreign corporation. Undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign corporation[1484] as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed and not reduced by dividends[1485] distributed during that taxable year. Undistributed foreign earnings are the portion of the undistributed earnings attributable to neither income described in section 245(a)(5)(A) nor section 245(a)(5)(B), without regard to section 245(a)(12).

Hybrid Dividends

The DRD is not available for any dividend received by a U.S. shareholder from a controlled foreign corporation if the dividend is a hybrid dividend. A hybrid dividend is an amount received from a controlled foreign corporation for which a deduction would be allowed under this provision and for which the specified 10-percent owned foreign corporation received a deduction (or other tax benefit) from taxes imposed by a foreign country.

If a controlled foreign corporation with respect to which a domestic corporation is a U.S. shareholder receives a hybrid dividend from any other controlled foreign corporation with respect to which the domestic corporation is also a U.S. shareholder, then the hybrid dividend is treated for purposes of section 951(a)(1)(A) as subpart F income of the recipient controlled foreign corporation for the taxable year of the controlled foreign corporation in which the dividends was received and the U.S. shareholder includes in gross income an amount equal to the shareholder's pro rata share of the subpart F income, determined in the same manner as section 951(a)(2).

Foreign tax credit disallowance

No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to a dividend that qualifies for the DRD.

For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a U.S. shareholder of a specified 10-percent owned foreign corporation must compute its foreign-source taxable income by disregarding the foreign-source portion of any dividend received from that foreign corporation for which the DRD is taken, and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Holding period requirement

A domestic corporation is not permitted a DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend. For this purpose, the holding period requirement is treated as met only if the specified 10-percent owned foreign corporation is a specified 10-percent owned foreign corporation at all times during the period and the taxpayer is a U.S. shareholder with respect to such specified 10-percent owned foreign corporation at all times during the period.

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.

CONFERENCE AGREEMENT

In general

The provision in the conference agreement generally follows the provision in the Senate amendment, with some changes, as described below, and allows an exemption for certain foreign income 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[1486] that are United States shareholders of those foreign corporations within the meaning of section 951(b)[1487] (referred to here, as above, as ''DRD'').

A specified 10-percent owned foreign corporation is any foreign corporation (other than a PFIC that is not also a CFC) with respect to which any domestic corporation is a U.S. shareholder.[1488]

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. For example, if a domestic corporation indirectly owns stock of a foreign corporation through a 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.

The DRD is available only to C corporations that are not RICs or REITs.

Foreign-source portion of a dividend

The DRD is available only for the foreign-source portion of dividends received by a domestic corporation 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 undistributed foreign earnings bears to the total undistributed earnings of the foreign corporation. Undistributed earnings are the amount of the earnings and profits of a specified 10-percent owned foreign corporation[1489] as of the close of the taxable year of the specified 10-percent owned foreign corporation in which the dividend is distributed and not reduced by dividends[1490] distributed during that taxable year. Undistributed foreign earnings are the portion of the undistributed earnings attributable to neither income described in section 245(a)(5)(A) nor section 245(a)(5)(B), without regard to section 245(a)(12).

Hybrid dividends

The DRD is not available for any dividend received by a U.S. shareholder from a controlled foreign corporation if the dividend is a hybrid dividend. A hybrid dividend is an amount received from a controlled foreign corporation for which a deduction would be allowed under this provision and for which the specified 10-percent owned foreign corporation received a deduction (or other tax benefit) with respect to any income, war profits, and excess profits taxes imposed by any foreign country.

If a controlled foreign corporation with respect to which a domestic corporation is a U.S. shareholder receives a hybrid dividend from any other controlled foreign corporation with respect to which the domestic corporation is also a U.S. shareholder, then the hybrid dividend is treated for purposes of section 951(a)(1)(A) as subpart F income of the recipient controlled foreign corporation (notwithstanding section 954(c)(6)) for the taxable year of the controlled foreign corporation in which the dividends was received and the U.S. shareholder includes in gross income an amount equal to the shareholder's pro rata share of the subpart F income, determined in the same manner as section 951(a)(2).

Foreign tax credit disallowance

No foreign tax credit or deduction is allowed for any taxes paid or accrued with respect to any portion of a distribution treated as a dividend that qualifies for the DRD.

For purposes of computing the section 904(a) foreign tax credit limitation, a domestic corporation that is a U.S. 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 DRD is taken, and any deductions properly allocable or apportioned to that foreign-source portion or the stock with respect to which it is paid.

Holding period requirement

A domestic corporation is not permitted a DRD in respect of any dividend on any share of stock that is held by the domestic corporation for 365 days or less during the 731-day period beginning on the date that is 365 days before the date on which the share becomes ex-dividend with respect to the dividend. For this purpose, the holding period requirement is treated as met only if the specified 10-percent owned foreign corporation is a specified 10-percent owned foreign corporation at all times during the period and the taxpayer is a U.S. shareholder with respect to such specified 10-percent owned foreign corporation at all times during the 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.

2. Modification of subpart F inclusion for increased investments in United States property (sec. 4002 of the House bill, sec. 14218 of the Senate amendment, and sec. 956 of the Code)

HOUSE BILL

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.

SENATE AMENDMENT

The provision excepts domestic corporations that are U.S. shareholders in the CFC

[1484] Computed in accordance with secs. 964(a) and 986.

[1485] Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.

[1486] Including a controlled foreign corporation treated as a domestic corporation for purposes of computing the taxable income thereof. See Treas. Reg. sec. 1.952–2(b)(1). Therefore, a CFC receiving a dividend from a 10-percent owned foreign corporation that constitutes subpart F income may be eligible for the DRD with respect to such income.

[1487] Under section 951(b) as revised by the Act, 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 vote or value of the foreign corporation.

[1488] Secs. 1297, 1298.

[1489] Computed in accordance with secs. 964(a) and 986.

[1490] Pursuant to section 959(d), a distribution of previously taxed income does not constitute a dividend even if it reduces earnings and profits.

from the requirement that they recognize income when the CFC increases its investment in U.S. property.

Effective date.—The provision applies to taxable years of foreign corporations beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not follow the House bill or the Senate amendment.

3. Special rules relating to sales or transfers involving specified 10-percent owned foreign corporations (sec. 4003 of the House bill, sec. 14102 of the Senate Amendment and secs. 367(a)(3)(C), 961, 1248 and new sec. 91 of the Code)

HOUSE BILL

Reduction in basis of certain foreign stock

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.

SENATE AMENDMENT

Sales by United States persons of stock

In the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for one year or more, any amount received by the domestic corporation which is treated as a dividend for purposes of section 1248, is treated as a dividend for purposes of applying the provision.

Reduction in basis of certain foreign stock

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 this provision) 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 specified 10-percent owned foreign corporation's stock has already been reduced pursuant to section 1059.

Sale by a CFC of a lower-tier CFC

If for any taxable year of a CFC beginning after December 31, 2017, an amount is treated as a dividend under section 964(e)(1) because of a sale or exchange by the CFC of stock in another foreign corporation held for a year or more, then: (i) the foreign-source portion of the dividend is treated as subpart F income of the selling CFC for purposes of section 951(a)(1)(A), (ii) a United States shareholder with respect to the selling CFC includes in gross income for the taxable year of the shareholder with or within the taxable year of the CFC ends, an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the amount treated as subpart F income under (i), and (iii) the deduction under section 245A(a) is allowable to the United States shareholder with respect to the subpart F income included in gross income under (ii) in the same manner as if the subpart F income were a dividend received by the shareholder from the selling CFC.

In the case of a sale or exchange by a CFC of stock in another corporation in a taxable year of the selling CFC beginning after December 31, 2017, to which this provision applies if gain were recognized, rules similar to those in section 961(d) apply.

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) as in effect before the date of enactment of TCJA) to a specified 10-percent owned foreign corporation with respect to which it is a U.S. shareholder after the transfer, 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 (if any) of: (1) losses incurred by the foreign branch after December 31, 2017, and before the transfer, for which a deduction was allowed to the domestic corporation, over (2) the sum of certain 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. The transferred loss amount is reduced by the amount of gain recognized by the taxpayer (other than gain recognized by reason of an overall foreign loss recapture) on account of the transfer.

The amount of loss included in the gross income of the taxpayer under the proposed rule above for any taxable year cannot exceed the amount allowed as a deduction under new section 245A for the taxable year (taking into account dividends received from all specified 10-percent owned foreign corporations with respect to which the taxpayer is a U.S. shareholder). Any amount not included in gross income for a taxable year because of this proposed rule is included in gross income in the succeeding taxable year.

Amounts included in gross income by reason of the provision are treated as derived from sources within the United States. Consistent with regulations or guidance that the Secretary of the Treasury may prescribe, proper adjustments are 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 provision.

Repeal of active trade or business exception

Section 367 is amended to provide that in connection with any exchange described in section 332, 351, 354, 356, or 361, if a U.S. person transfers property used in the active conduct of a trade or business to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation.

Effective date.—The provision relating to reduction of basis in certain foreign stock for the purposes of determining a loss is effective for dividends received in taxable years beginning after December 31, 2017.

The provisions relating to transfer of loss amounts from foreign branches to certain foreign corporations and to the repeal of the active trade or business exception are effective for transfers after December 31, 2017.

CONFERENCE AGREEMENT

The provision in the conference agreement retains elements of both the House Bill and the Senate amendment, as follows.

Sales by United States persons of stock

In the case of the sale or exchange by a domestic corporation of stock in a foreign corporation held for one year or more, any amount received by the domestic corporation which is treated as a dividend for purposes of section 1248, is treated as a dividend for purposes of applying the provision.

Reduction in basis of certain foreign stock

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 this provision) 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 specified 10-percent owned foreign corporation's stock has already been reduced pursuant to section 1059.

Sale by a CFC of a lower-tier CFC

If for any taxable year of a CFC beginning after December 31, 2017, an amount is treated as a dividend under section 964(e)(1) because of a sale or exchange by the CFC of stock in another foreign corporation held for a year or more, then: (i) the foreign-source portion of the dividend is treated as subpart F income of the selling CFC for purposes of section 951(a)(1)(A), (ii) a United States shareholder with respect to the selling CFC includes in gross income for the taxable year of the shareholder with or within the taxable year of the CFC ends, an amount equal to the shareholder's pro rata share (determined in the same manner as under section 951(a)(2)) of the amount treated as subpart F income under (i), and (iii) the deduction under section 245A(a) is allowable to the United States shareholder with respect to the subpart F income included in gross income under (ii) in the same manner as if the subpart F income were a dividend received by the shareholder from the selling CFC.

In the case of a sale or exchange by a CFC of stock in another corporation in a taxable year of the selling CFC beginning after December 31, 2017, to which this provision applies if gain were recognized, rules similar to section 961(d) apply.

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)) as in effect before the date of enactment of TCJA) to a specified 10-percent owned foreign corporation with respect to which it is a U.S. shareholder after the transfer, 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 (if any) of: (1) losses incurred by the foreign branch after December 31, 2017, and before the transfer, for which a deduction was allowed to the domestic corporation, over (2) the sum of certain 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. The transferred loss amount is reduced by the amount of gain recognized by the taxpayer (other than gain recognized by reason of an overall foreign loss recapture) on account of the transfer.

Amounts included in gross income by reason of the provision are treated as derived from sources within the United States. Consistent with regulations or guidance that the Secretary of the Treasury may prescribe, proper adjustments are 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 provision.

The amount of gain taken into account under this provision is reduced by the amount of gain which would be recognized under section 367(a)(3)(C) as in effect before the date of enactment of TCJA[1491] with respect to losses incurred before January 1, 2018.

Repeal of active trade or business exception

Section 367 is amended to provide that in connection with any exchange described in section 332, 351, 354, 356, or 361, if a U.S. person transfers property used in the active conduct of a trade or business to a foreign corporation, such foreign corporation shall not, for purposes of determining the extent to which gain shall be recognized on such transfer, be considered to be a corporation.

Effective date.—The provisions relating to sales or exchanges of stock apply to sales or exchanges after December 31, 2017.

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 provisions relating to transfer of loss amounts from foreign branches to certain foreign corporations and to the repeal of the active trade or business are effective for transfers after December 31, 2017.

4. Treatment of deferred foreign income upon transition to participation exemption system of taxation and deemed repatriation at two-tier rate (sec. 4004 of the House bill, sec. 14103 of the Senate amendment, and secs. 78, 904, 907 and 965 of the Code)

HOUSE BILL

In general

The provision generally requires that, for the last taxable year of a foreign corporation beginning before January 1, 2018, all 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 their pro rata shares of the accumulated post-1986 deferred foreign income that 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 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 all specified foreign corporations is increased for the last taxable year[1492] 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 applies to all U.S. shareholders[1493] 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.[1494] 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.[1495]

Accumulated post-1986 deferred foreign income

Accumulated post-1986 deferred foreign income of a specified foreign corporation that is the subject of the 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 that are (1) not 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, not 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 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 distributions during the taxable year to which section 965 applies. Such earnings are increased by the amount of qualified deficits[1496] 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.

The Secretary may prescribe appropriate rules 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.[1497]

Reductions of amounts included in income of U.S. shareholder of foreign corporations with deficits in earnings and profits

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 an ‘‘E&P deficit foreign corporation.’’ 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

[1491] Determined without regard to the rule providing for proper adjustment of basis in the stock in the specified 10-percent owned foreign corporation to which the transfer is made.

[1492] 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.

[1493] 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.

[1494] Taxation of income earned by PFICs remains subject to the antideferral PFIC regime and are ineligible for the dividend received deduction under new section 245A.

[1495] For purposes of taking into account its subpart F income under this rule, a noncontrolled 10/50 corporation is treated as a CFC.

[1496] Sec. 952(c)(1)(B)(ii).

[1497] 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.

determining the aggregate foreign earnings and profits deficit of a U.S. shareholder.[1498]

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 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 earnings and profits 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	70%	$2,000	$1,400
D	100%	$1,000	$1,000

The aggregate foreign earnings and profits 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 earnings and profits deficit allocable to Corporation C is ($362), that is, ($620) × 1400/2400. The remainder of the aggregate foreign earnings and profits deficit is allocable to Corporation D. The U.S. shareholder has a net surplus of earnings and profits 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, a U.S. corporation may have two domestic subsidiaries, X and Y, in 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 may be 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 domestic 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.

[1498] 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.

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 sum 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 included.

Certain reductions from aggregate cash position are specified in the provision. First, rules are provided to avoid the double counting of cash position 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 that the earnings constitute blocked income that could not be distributed by the corporation due to local jurisdiction restrictions,[1499] 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 he determines had the principal purpose of reducing the aggregate foreign cash position.

[1499] Sec. 964(b) and regulations thereunder.

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 is it 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-percent of foreign taxes paid attributable to the remaining portion of the section 965 inclusion.[1500]

The provision coordinates the disallowance of foreign tax credits described above with the requirement[1501] 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 the 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 the fraction, 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 available 10 year 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

[1500] Other foreign tax credits used by a taxpayer against tax liability resulting from the deemed inclusion apply in full.

[1501] Sec. 78.

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 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 case or similar proceeding, 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.[1502] 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.

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.

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.

SENATE AMENDMENT

In general

The provision generally requires that, for the last taxable year beginning before January 1, 2018, any U.S. shareholder of a specified foreign corporation must include in income its pro rata share of the accumulated post-1986 deferred foreign income of the corporation. For purposes of this provision, a specified foreign corporation is any foreign corporation that has at least one U.S. shareholder. It excludes PFICs that are not also CFCs. A portion of that pro rata share of foreign earnings is deductible; the amount of the deductible portion depends upon whether the deferred earnings are held in cash or other assets. The deduction results in a reduced rate of tax with respect to income from the required inclusion of pre-effective date earnings. A corresponding portion of the credit for foreign taxes is disallowed, thus limiting the credit to the taxable portion of the included income. The separate foreign tax credit limitation rules of present law section 904 apply, with coordinating rules. The increased tax liability generally may be paid over an eight-year period. Special rules are provided for S corporations and real estate investment trusts (''REITs'').

Subpart F

The mechanism for requiring an inclusion of pre-effective-date foreign earnings is subpart F. The provision provides that in the last taxable year of a deferred foreign income corporation that begins before January 1, 2018, which is that foreign corporation's last taxable year before the transition to the new corporate tax regime elsewhere in the bill goes into effect, the subpart F income of the foreign corporation is increased by the greater of the accumulated post-1986 deferred foreign income of the corporation, determined as of November 9, 2017, or as of December 31, 2017 (''measurement date''). The amount so determined is includible in gross income under section 951 (hereinafter, ''the section 951 inclusion'').

The transition rule applies to all U.S. shareholders[1503] of a deferred foreign income corporation. ''Deferred foreign income corporation'' is any specified foreign corporation with accumulated post-1986 deferred income that is greater than zero. A specified foreign corporation is defined as any CFC as well as any section 902 corporation, as defined in section 909(d)(5) prior to date of enactment of this bill, *i.e.*, any foreign corporation in which a U.S. person owns 10 percent of the voting stock. Consistent with the general operation of subpart F, each U.S. shareholder of a deferred foreign income corporation must include in income the shareholder's pro rata share of the foreign corporation's subpart F income attributable to its section 951 inclusion.[1504]

Accumulated post-1986 deferred foreign income

A specified foreign corporation's accumulated post-1986 deferred foreign income on the measurement date is based on all post-1986 foreign earnings and profits (''E&P'') that are not previously taxed and are neither (1) attributable to income that is effectively connected with the conduct of a trade or business in the United States and subject to U.S. income tax nor (2) subpart F income (determined without regard to the section 951 inclusion) included in the gross income of a U.S. shareholder. The potential pool of includible earnings includes all undistributed foreign earnings accumulated in taxable years beginning after 1986, computed in accordance with sections 964(a) and 986, taking into account only periods when the foreign corporation was a specified corporation. The pool of post-1986 foreign earnings and profits is not reduced by distributions during the taxable year to which section 965 applies.

Reductions of amounts included in income of U.S. shareholder of foreign corporations with deficits in E&P

The pool of post-1986 earnings and profits taken into consideration in computing the section 951 inclusion required of a U.S. shareholder under this transition rule generally is reduced by foreign earnings and profits deficits that are properly allocated to that person. The U.S. shareholder must determine its aggregate E&P deficit based on its interest in each specified foreign corporation with a deficit in post-1986 foreign earnings and profits as of the measurement date (''E&P deficit foreign corporation'').

The U.S. shareholder's aggregate E&P deficit is then allocated among the deferred foreign income corporations 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 foreign income corporations with respect to which the shareholder is a U.S. shareholder. For the portion of aggregate E&P deficits that include qualified deficits, the portion of the deficit that is attributable to a qualified deficit, and the qualified activity, must be identified. The

[1502] 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.

[1503] Sec. 951(b) defines United States shareholder as any U.S. person that owns 10 percent or more of combined voting classes of stock of a foreign corporation.

[1504] For purposes of taking into account its subpart F income under this rule, a noncontrolled section 902 corporation is treated as a CFC.

provision does not permit intragroup netting among U.S. shareholders within an affiliated group.

In taxable years beginning after 2017, amounts by which the section 951 inclusion was reduced by aggregate E&P deficits are considered as amounts included in the gross income of the U.S. shareholder. The shareholder's pro rata share of the E&P of an E&P deficit foreign corporation that used qualified deficits to reduce its section 951 inclusion is increased by the amount of such deficit and attributed to the same activity to which the income was attributed.

Deductions from section 951 inclusion

To determine the taxable portion of the section 951 inclusion, the U.S. shareholders with accumulated deferred foreign income may deduct a portion of the section 951 inclusion in an amount that depends upon the proportion of aggregate earnings and profits attributable to cash assets rather than noncash assets, in the nature of a partial dividends-received deduction. A U.S. shareholder may deduct 71.4 percent of the aggregate earnings and profits attributable to cash assets, and 85.7 percent of the remainder of the aggregate earnings and profits in the section 951 inclusion.[1505]

A U.S. shareholder may elect, no later than with a timely filed return for the taxable year, not to apply its net operating loss deduction to the deemed repatriation. If so, neither the section 951 inclusion nor any related deemed paid foreign tax credits may be taken into account in computing the net operating loss deduction for that year.

Cash position

The aggregate earnings and profits attributable to cash assets for a U.S. shareholder is the greater of the pro rata share of the cash position of all specified foreign corporations as of the last day of the last taxable year beginning before January 1, 2018, or the average of the cash position determined on the last day of each of the two taxable years ending immediately before November 9, 2017. 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 (other than stock in the specified foreign corporation) government securities, certificates of deposit, commercial paper, and short-term obligations.

To avoid double counting of cash assets, a U.S. shareholder may disregard accounts receivable and short-term obligations of a specified foreign corporation if that shareholder can establish that the amounts were already taken into account by that shareholder with respect to another specified foreign corporation.

The Secretary may identify other assets that are economically equivalent to the enumerated assets that are treated as cash. 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 credit

A portion of foreign income tax that is deemed paid or accrued with respect to the section 951 inclusion is not creditable or deductible against the Federal income tax attributable to the inclusion. The disallowed portion of foreign tax credits is 71.4 percent of foreign taxes paid attributable to the portion of the section 965 inclusion attributable to the aggregate cash position plus, 85.7 percent of foreign taxes paid attributable to the remaining portion of the section 965 inclusion.[1506] The provision coordinates the disallowance of foreign tax credits with the requirement[1507] 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.

Limitations on assessment extended

The provision also allows an exception to the otherwise applicable limitations period for assessment of tax to ensure that the period for assessment of underpayments in tax related to the treatment of the pre-effective date foreign earnings does not expire prior to six years from the date on which the return initially reflecting the section 951 inclusion was filed.

Installment payments

The Senate amendment follows the House provision in allowing a U.S. shareholder to elect to pay the net tax liability resulting from the section 951 inclusion in eight installments. However, if installment payment is elected, rather than requiring eight equal installments, the Senate amendment requires that the payments for each of the first five years equal 8 percent of the net tax liability, the sixth installment equals 15 percent of the net tax liability, increasing to 20 percent for the seventh installment and the remaining balance of 25 percent in the eighth year.

Special rule for S corporations

The Senate amendment also includes the special rule of the House provision that 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.[1508] After a triggering event occurs, a shareholder in the S corporation may elect to pay the net tax liability in eight installments, subject to rules similar to those generally applicable absent deferral.

Special rules for REITs

To alleviate burden of compliance with this section by REITs, special rules are provided if a U.S. shareholder is a REIT. First, although it must determine its pro rata share of the increase in subpart F income in accordance with the rules described above, the REIT is not required to take into account the section 951 inclusion for purposes of determining the REIT's amount of qualified REIT gross income.[1509] The section 951 inclusion is, however, taken into account for purposes of determining the income potentially required to be included in taxable income under section 857(b). Unlike a regular subchapter C corporation, a REIT is able to deduct the portion of its income that is distributed to its shareholders as a dividend or qualifying liquidating distribution each year.[1510] The distributed income of the REIT is not taxed at the entity level; instead, it is taxed once, at the investor level. As a result, a required inclusion under this section may trigger a requirement that the REIT distribute an amount equal to 90 percent of that inclusion despite the fact that it received no distribution from the deferred foreign income corporation.

To avoid requiring that any distribution requirement be satisfied in one year, an election to defer the section 951 inclusion is permitted. Under a timely election, a REIT may instead take the amounts into income over a period of eight years. It must include 8 percent in each of the five years beginning with the initial year in which the section 951 inclusion is determined, 15 percent in the sixth year, 20 percent in the seventh year and 25 percent in the eighth year. In each of those years, it may claim a partial dividends-received deduction in the applicable percentages in proportion to the amount included in each of the eight years. Neither the REIT nor the recipient of the distribution may elect to use the installment payment.

In the event that a REIT liquidates, ceases to operate its business, or distributes substantially all its assets (or any other similar event occurs), any portion of the required inclusion not yet taken into income is accelerated and required to be included as gross income as of the day before the event.

Recapture from expatriated entities

The provision denies any deduction claimed with respect to the mandatory subpart F inclusion and imposes a 35-percent tax on the entire inclusion if a U.S. shareholder becomes an expatriated entity within the meaning of section 7874(a)(2) at any point within the ten-year period following enactment of the Tax Cuts and Jobs Act. An entity that becomes a surrogate foreign corporation that is treated as a domestic corporation under section 7874(b) is not within the scope of this recapture provision. Although the amount due is computed by reference to the year in which the deemed subpart F income was originally reported, the additional tax arises and is assessed for the taxable year in which the U.S. shareholder becomes an expatriated entity. No foreign tax credits are permitted with respect to the additional tax due as a result of the recapture rule.

Regulatory authority

A specific grant of regulatory authority to carry out the intent of this provision is included. For example, the Secretary may identify instances in which it is appropriate to grant relief from potential double-counting of earnings and profits, which may occur due to different measurement dates applicable to specified foreign corporations within an affiliated group, or the timing of intragroup distributions. It also specifies that the Secretary shall prescribe rules or guidance in order to deter tax avoidance through use of entity classification elections and accounting method changes, among other possible strategies.

Effective date.—The provision is effective for the last taxable year of a foreign corporation that begins before January 1, 2018, and

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[1505] Committee Print, *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. 115–20, (December 2017), as reprinted on the website of the Senate Budget Committee, available at *https://www.budget.senate.gov/taxreform.*, at footnote 1198, indicated that the income deducted was to be treated as exempt from tax, with the result that the deducted income, if earned by a partnership, could give rise to an increase in a partner's basis under section 705(a)(1)(B).

[1506] Other foreign tax credits used by a taxpayer against tax liability resulting from the deemed inclusion apply in full.

[1507] Sec. 78.

[1508] 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 no more than 100 shareholders, none of whom are nonresident aliens, and all of whom are individuals, estates, trusts or certain exempt organizations.

[1509] To qualify as a REIT, an entity must meet certain income requirements. A REIT is restricted to earning certain types of generally passive income. Among other requirements, at least 75 percent of the gross income of a REIT in each taxable year must consist of real estate-related income. Secs. 856. In addition, a REIT is required to distribute at least 90 percent of REIT income (other than net capital gain) annually. Sec. 857. Even if a REIT meets the 90-percent income distribution requirement for REIT qualification, more stringent distribution requirements must be met in order to avoid an excise tax under section 4981.

[1510] Liquidating distributions are covered to the extent of earnings and profits, and are defined to include redemptions of stock that are treated by shareholders as a sale of stock under section 302. Secs. 857(b)(2)(B), 561, and 562(b).

with respect to U.S. shareholders, for the taxable years in which or with which such taxable years of the foreign corporations end.

CONFERENCE AGREEMENT

The conference agreement generally follows the Senate amendment, with several modifications, including those described below.

Scope of earnings and profits subject to the transition tax

The provision applies to all CFCs. It also applies to all foreign corporations (other than PFICs), in which a U.S. person owns a 10-percent voting interest, rather than only CFCs and those corporations within the definition of section 902 corporation. However, in the case of a foreign corporation that is not a CFC, there must be at least one U.S. shareholder that is a domestic corporation in order for the foreign corporation to be a specified foreign corporation. Such entities must determine their deferred foreign income based on the greater of the aggregate post-1986 accumulated foreign earnings and profits as of November 2, 2017 or December 31, 2017, not reduced by distributions during the taxable year ending with or including the measurement date, unless such distributions were made to another specified foreign corporation. The portion of post-1986 earnings and profits subject to the transition tax does not include earnings and profits that were accumulated by a foreign company prior to attaining its status as a specified foreign corporation.

Deferred earnings of a U.S. shareholder are reduced (but not below zero) by the shareholder's share of deficits as of November 2, 2017, from a specified foreign corporation that is not a deferred foreign income corporations, including the pro rata share of deficits of another U.S. shareholder in a different U.S. ownership chain within the same U.S. affiliated group. The deficits (including hovering deficits[1511]) of a foreign subsidiary that accumulated while it was a specified foreign corporation may be taken into account in determining the aggregate foreign earnings and profits deficit of a U.S. shareholder. Therefore, the amount of post-1986 earnings and profits of a specified foreign corporation is the amount of positive earnings and profits accumulated as of the measurement date reduced by any deficit in earnings and profits of the specified foreign corporation as of the measurement date, without regard to the limitation category of the earnings or deficit. In taxable years beginning with the year of the section 951 inclusion, amounts by which the section 951 inclusion was reduced by aggregate E&P deficits are considered as amounts included in the gross income of the U.S. shareholder for purposes of applying section 959.

For example, assume that a foreign corporation organized after December 31, 1986 has $100 of accumulated earnings and profits as of November 2, 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. Foreign income taxes related to the hovering deficit, however, would not generally be deemed paid by the U.S. shareholder recognizing an incremental income inclusion. However, the conferees expect the Secretary may issue guidance to provide that, solely for purposes of calculating the amount of foreign income taxes deemed paid by the U.S. shareholder with respect to an inclusion under section 965, a hovering deficit may be absorbed by current year earnings and profits and the foreign income taxes related to the hovering deficit may be added to the specified foreign corporation's post-1986 foreign income taxes in that separate category on a pro rata basis in the year of inclusion.[1512]

In order to avoid double-counting and double non-counting of earnings, the Secretary may provide guidance to adjust the amount of post-1986 earnings and profits of a specified foreign corporation to ensure that a single item of a specified foreign corporation is taken into account only once in determining the income of a United States shareholder subject to this provision. Such an adjustment may be necessary, for example, when there is a deductible payment (e.g., interest or royalties) from one specified foreign corporation to another specified foreign corporation between measurement dates.

The conferees are also aware that certain taxpayers may have engaged in tax strategies designed to reduce the amount of post-1986 earnings and profits in order to decrease the amount of the inclusion required under this provision. Such tax strategies may include a change in entity classification, accounting method, and taxable year, or intragroup transactions such as distributions or liquidations. The conferees expect the Secretary to prescribe rules to adjust the amount of post-1986 earnings and profits in such cases in order to prevent the avoidance of the purposes of this section.

Furthermore, the conferees expect that the Secretary will exercise his authority under the consolidated return provisions to appropriately limit the netting across chains of ownership within a group of related parties in the application of this provision. However, nothing in this provision is intended to be interpreted as limiting the Secretary's authority to use such regulatory authority to prescribe regulations on proper application of this section on a consolidated basis for affiliated groups filing a consolidated return.

Application of participation exemption deduction and related foreign tax credits

Instead of prescribing a fixed percentage of the section 951 inclusion resulting from section 965 for which a partial dividends-received deduction is permitted, the conference agreement adopts the rate equivalent percentage method used in the House bill. As a result, the total deduction from the amount of the section 951 inclusion is the amount necessary to result in a 15.5-percent rate of tax on accumulated post-1986 foreign earnings held in the form of cash or cash equivalents, and 8-percent rate of tax on all other earnings. The calculation is based on the highest rate of tax applicable to corporations in the taxable year of inclusion, even if the U.S. shareholder is an individual.

The use of rate equivalent percentages is intended to ensure that the rates of tax imposed on the deferred foreign income is similar for all U.S. shareholders, regardless of the year in which section 965 gives rise to an income inclusion. Individual U.S. shareholders, and the investors in U.S. shareholders that are pass-through entities generally can elect application of corporate rates for the year of inclusion.[1513] In addition, the increase in income that is not taxed by reason of the partial dividends-received deduction allowed under this provision is treated as income exempt from tax for purposes of determining the basis in an interest in a partnership or subchapter S corporation, but not as income exempt from tax for purposes of determining the accumulated adjustments account of a subchapter S corporation.[1514] Similarly, the conferees expect the Secretary to provide regulations or other guidance that provide for similar treatment under section 986(c), such that any gain or loss recognized thereunder with respect to distributions of earnings previously taxed (or treated as previously taxed) by reason of section 965(a) will be diminished proportionately to the diminution of the net taxable income resulting from section 965(a) by reason of the deduction allowed under section 965(c).

To reflect the change in the applicable rates of deduction, the amounts by which foreign tax credits are reduced are also changed. In addition, the rules for coordination of this provision with the limitations on foreign tax credits follows the House provision. 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 the 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 the fraction, 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 conferees recognize that basis adjustments (increases or decreases) may be necessary with respect to both the stock of the deferred foreign income corporation and the E&P deficit foreign corporation and authorizes the Secretary to provide for such basis adjustments or other adjustments, as may be appropriate. For example, with respect to the stock of the deferred foreign income corporation, the Secretary may determine that a basis increase is appropriate in the taxable year of the section 951A inclusion or, alternatively, the Secretary may modify the application of section 961(b)(1) with respect to such stock. Moreover, with respect to the stock of the E&P deficit corporation, the Secretary may require a reduction in basis for the taxable year in which the U.S. shareholder's pro rata share of the earnings of the E&P deficit corporation are increased.

With respect to the denial of the partial dividend to any U.S. shareholder that becomes an expatriated entity within the meaning of section 7874(a)(2) at any point within the ten-year period following enactment of the Tax Cuts and Jobs Act, the conference agreement clarifies that U.S. shareholders acquired by a surrogate corporation are within the scope of the provision only if the surrogate corporation inverted post-enactment.

Determination of cash position

The determination of assets to be considered in measuring the cash position of an entity is modified in several ways. First, cash holdings of a specified foreign corporation in the form of publicly traded stock may be excluded to the extent that a U.S. shareholder can demonstrate that the value of such stock was taken into account as cash or cash equivalent by another specified foreign corporation with respect to which such shareholder is a U.S. shareholder.

The conference agreement also provides that the cash position of a U.S. shareholder does not generally include the cash attributable to a direct ownership interest in a partnership, but preserves the rule that cash positions of certain noncorporate foreign entities owned by a specified foreign corporation are taken into account if such entities

[1511] See, Treas. Reg. sec. 1.367(b)–7(d)(2) (definition of hovering deficit).

[1512] *Cf.* Treas. Reg. sec. 1.367(b)–7(d)(2)(ii) and (iii).

[1513] Sec. 962 allows individuals to make the election for a specific taxable year, subject to regulations provided by the Secretary.

[1514] Secs. 705(a)(1)(B), 1367(a)(1)(A) and 1368(e)(1)(A).

would be specified foreign corporations with respect to the U.S. shareholder if the entity were a foreign corporation. For example, if a U.S. shareholder owns a five-percent interest in a partnership, the balance of which is held by a specified foreign corporation with respect to which such shareholder is a U.S. shareholder, the partnership is treated as a specified foreign corporation with respect to the U.S. shareholder, and the cash or cash equivalents held by the partnership are includible in the aggregate cash position of the U.S. shareholder on a look-through basis. The conferees anticipate that the Secretary will provide guidance for taking into account only the specified foreign corporation's share of the partnership's cash position, and not the five-percent interest directly owned by the U.S. shareholder.

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.

15. Election to increase percentage of domestic taxable income offset by overall domestic loss treated as foreign source (sec. 14305 of the Senate amendment and sec. 904(g) of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision modifies section 904(g) by providing an election to increase the percentage (but not greater than 100 percent) of domestic taxable income offset by any pre-2018 unused overall domestic loss and recharacterized as foreign source. The term "pre-2018 unused overall domestic loss" means any overall domestic loss which: (1) arises in a qualified taxable year beginning before January 1, 2018, and (2) has not been used under the general rule set forth in section 904(g)(1). The term "qualified taxable year" means any taxable year of the taxpayer beginning after December 31, 2017, and before January 1, 2028.

Effective date.—The provision shall apply to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

B. Rules Related to Passive and Mobile Income

1. Deduction for foreign-derived intangible income and global intangible low-taxed income (sec. 14202 of the Senate amendment and new sec. 250 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

In general

The provision provides domestic corporations with reduced rates of U.S. tax on their foreign-derived intangible income ("FDII") and global intangible low-taxed income ("GILTI").[1515] GILTI is defined in section 14201 of the Senate amendment and new section 951A, while a domestic corporation's FDII is the portion of its intangible income, determined on a formulaic basis, that is derived from serving foreign markets. For taxable years beginning after December 31, 2017, and before January 1, 2019, the effective tax rate on FDII is 21.875 percent and the effective U.S. tax rate on GILTI is 17.5 percent under the Senate amendment.[1516] For taxable years beginning after December 31, 2018, and before January 1, 2026, the effective tax rate on FDII is 12.5 percent and the effective U.S. tax rate on GILTI is 10 percent. For taxable years beginning after December 31, 2025, the effective tax rate on FDII is 15.625 percent and the effective U.S. tax rate on GILTI is 12.5 percent.

Deduction for FDII and GILTI

Deduction for FDII and GILTI and taxable income limitation

In the case of domestic corporations for taxable years beginning after December 31, 2017, and before January 1, 2026, the provision generally allows as a deduction an amount equal to the sum of 37.5 percent of its FDII plus 50 percent of its GILTI (if any). For taxable years beginning after December 31, 2025, the deduction for FDII is reduced to 21.875 percent and the deduction for GILTI is lowered to 37.5 percent.[1517]

If the sum of a domestic corporation's FDII and GILTI amounts exceeds its taxable income determined without regard to this provision, then the amount of FDII and GILTI for which a deduction is allowed is reduced by an amount determined by such excess. The reduction in FDII for which a deduction is allowed equals such excess multiplied by a percentage equal to the corporation's FDII divided by the sum of its FDII and GILTI. The reduction in GILTI for which a deduction is allowed equals the remainder of such excess.[1518]

FDII

The FDII of any domestic corporation is the amount which bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction eligible income bears to its deduction eligible income. In other words, a domestic corporation's FDII is its deemed intangible income multiplied by the percentage of its deduction eligible income that is foreign-derived. The calculation can also be expressed as the following:

$$FDII = Deemed\ Intangible\ Income \times \frac{Foreign\text{-}Derived\ Deduction\ Eligible\ Income}{Deduction\ Eligible\ Income}$$

The Secretary is authorized to prescribe regulations or other guidance as may be necessary or appropriate to carry out this provision.

Deduction eligible income

Deduction eligible income means, with respect to any domestic corporation, the excess (if any) of the gross income of the corporation—determined without regard to certain exceptions to deduction eligible income—over deductions (including taxes) properly allocable to such gross income (referred to in this document as "deduction eligible gross income"). The exceptions to deduction eligible income are: (1) the subpart F income of the corporation determined under section 951; (2) the GILTI of the corporation; (3) any financial services income (as defined in section 904(d)(2)(D)) of the corporation; (4) any dividend received from a CFC with respect to which the corporation is a U.S. shareholder; and (5) any domestic oil and gas extraction income of the corporation; and (6) any foreign branch income (as defined in section 904(d)(2)(J)) of the corporation.

The formula for deduction eligible income can generally be written as follows:[1519]

Deduction Eligible Income = Gross Income − Exceptions − Allocable Deductions

where *Exceptions* refers to the exceptions to deduction eligible income and *Allocable Deductions* encompass all deductions (including taxes) property allocable to deduction eligible gross income.

Deemed intangible income

The domestic corporation's deemed intangible income means the excess (if any) of its deduction eligible income over its deemed tangible income return. The deemed tangible income return means, with respect to any corporation, an amount equal to 10 percent of the corporation's qualified business asset investment ("QBAI"). Deemed intangible income can be calculated as follows:[1520]

Deemed Intangible Income = Deduction Eligible Income − (10% × QBAI)

For purposes of computing its FDII, a domestic corporation's QBAI is the average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under section 168(g), notwithstanding any provision of law (or any other section of the Senate amendment) which is enacted after the date of enactment of this provision (unless such later enacted law specifically and directly amends this provision's definition).

Specified tangible property means any tangible property used in the production of deduction eligible income. If such property was used in the production of deduction eligible income and income that is not deduction eligible income (*i.e.*, dual-use property), the property is treated as specified tangible property in the same proportion that the amount of deduction eligible gross income produced with respect to the property bears to the total amount of gross income produced with respect to the property.[1521] In

[1515] The deduction for FDII and GILTI is only available to domestic corporations. U.S. shareholders that are not domestic corporations are subject to full U.S. tax on their GILTI.

[1516] Under sec. 13001 of the Senate amendment, the corporate tax rate is reduced to 20 percent for taxable years beginning after December 31, 2018.

[1517] The Committee intends that the deduction allowed by new Code section 250 be treated as exempting the deducted income from tax. Thus, for example, the deduction for global intangible low-taxed income could give rise to an increase in a domestic corporate partner's basis in a domestic partnership under section 705(a)(1)(B).

[1518] For example, consider a domestic corporation with $1,250 of FDII, $750 of GILTI, and taxable income (determined without regard to this provision) of $1,500. The sum of the corporation's FDII and GILTI amounts is $2,000, which exceeds $1,500 by $500. For purposes of this provision, the amount of FDII for which a deduction is allowed is reduced by $500 multiplied by $1,250/$2,000, or $312.50. The amount of GILTI for which a deduction is allowed is reduced by the remainder of the excess, or $187.50 (= $500 × $750/$2,000).

[1519] This formula assumes that the excess described in the preceding paragraph is positive. Otherwise there is no deduction eligible income.

[1520] If the quantity in this formula is negative, deemed intangible income is zero.

[1521] For example, if a building is used in the production of $1,000 of total gross income for a taxable

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other words, the percentage of a domestic corporation's adjusted basis in dual-use property that is included in QBAI equals the deduction eligible gross income produced with respect to the property divided by the total gross income produced with respect to the property.

Foreign-derived deduction eligible income

Foreign-derived deduction eligible income means, with respect to a taxpayer for its taxable year, any deduction eligible income of the taxpayer that is derived in connection with (1) property that is sold by the taxpayer to any person who is not a United States person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use[1522] or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States. Foreign use means any use, consumption, or disposition that is not within the United States. Special rules for determining foreign use apply to transactions that involve property or services provided to domestic intermediaries or related parties.

For purposes of the provision, the terms ''sold,'' ''sells'', and ''sale'' include any lease, license, exchange, or other disposition.

Property or services provided to domestic intermediaries

If a taxpayer sells property to another person (other than a related party) for further manufacture or modification within the United States, the property is generally not treated as sold for a foreign use even if such other person subsequently uses such property for foreign use. However, there is an exception to this general rule for property (1) that is ultimately sold by a related party, or used by a related party in connection with property that is sold or the provision of services, to another person who is an unrelated party who is not a U.S. person and (2) that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use.[1523] Deduction eligible income derived in connection with services provided to another person (other than a related party) located within the United States is not treated as foreign-derived deduction eligible income, even if the other person uses the services in providing services the income from which is considered foreign-derived deduction eligible income.

Special rules with respect to related party transactions

If property is sold to a related foreign party, the sale is not treated as for a foreign use unless the property is sold by the related foreign party to another person who is unrelated and is not a U.S. person and the taxpayer establishes to the satisfaction of the Secretary that such property is for a foreign use. Income derived in connection with services provided to a related party who is not located in the United States is not treated as foreign-derived deduction eligible income unless the taxpayer establishes to the satisfaction of the Secretary that such service is not substantially similar to services provided by the related party to persons located within the United States.

For purposes of applying these rules, a related party means any member of 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 sections 1504(b)(2) and 1504(b)(3). Any person (other than a corporation) is treated as a member of the affiliated group if the person is controlled by members of the group (including any entity treated as a member of the group by reason of this sentence) or controls any member, with control being determined under the rules of section 954(d)(3).

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with clarifications and modifications that include the following:

- The deduction for FDII and GILTI is available only to C corporations that are not RICs or REITs.[1524]
- The deduction for GILTI applies to the amount treated as a dividend received by a domestic corporation under section 78 that is attributable to the corporation's GILTI amount under new section 951A.
- The exclusions from deduction eligible income are clarified.
- The definition of deemed tangible income return is clarified.

Illustration of effective tax rates on FDII and GILTI

Under a 21-percent corporate tax rate, and as a result of the deduction for FDII and GILTI, the effective tax rate on FDII is 13.125 percent and the effective U.S. tax rate on GILTI (with respect to domestic corporations) is 10.5 percent for taxable years beginning after December 31, 2017, and before January 1, 2026.[1525] Since only a portion (80 percent) of foreign tax credits are allowed to offset U.S. tax on GILTI, the minimum foreign tax rate, with respect to GILTI, at which no U.S. residual tax is owed by a domestic corporation is 13.125 percent.[1526] If the foreign tax rate on GILTI is zero percent, then the U.S. residual tax rate on GILTI is 10.5 percent. Therefore, as foreign tax rates on GILTI range between zero percent and 13.125 percent, the total combined foreign and U.S. tax rate on GILTI ranges between 10.5 percent and 13.125 percent. At foreign tax rates greater than or equal to 13.125 percent, there is no residual U.S. tax owed on GILTI, so that the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate.

For domestic corporations in taxable years beginning after December 31, 2025, the effective tax rate on FDII is 16.406 percent and the effective U.S. tax rate on GILTI is 13.125 percent. The minimum foreign tax rate, with respect to GILTI, at which no U.S. residual tax is owed is 16.406 percent.[1527]

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

2. Special rules for transfers of intangible property from controlled foreign corporations to United States shareholders (sec. 14203 of the Senate amendment and new sec. 966 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

For certain distributions of intangible property held by a CFC on the date of enactment of this provision, the fair market value of the property on the date of the distribution is treated as not exceeding the adjusted basis of the property immediately before the distribution. If the distribution is not a dividend, a U.S. shareholder's adjusted basis in the stock of the CFC with respect to which the distribution is made is increased by the amount (if any) of the distribution that would, but for this provision, be includible in gross income. The adjusted basis of the property in the hands of the U.S. shareholder immediately after the distribution is the adjusted basis immediately before the distribution, reduced by the amount of the increase (if any) described previously.

For purposes of the provision, intangible property means intangible property as described in section 936(h)(3)(B) and computer software as described in section 197(e)(3)(B).

The provision applies to distributions that are (1) received by a domestic corporation from a CFC with respect to which it is a U.S. shareholder and (2) made by the CFC before the last day of the third taxable year of the CFC beginning after December 31, 2017.

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.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

C. 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 House bill, sec. 14301 of the Senate amendment, and secs. 902 and 960 of the Code)

HOUSE BILL

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.

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year, $250 of which was domestic oil and gas extraction income and the remaining $750 of which was deduction eligible gross income, then 75 percent of a domestic corporation's average adjusted basis in the building is included in QBAI for that taxable year.

[1522] If property is sold by a taxpayer to a person who is not a U.S. person, and after such sale the property is subject to manufacture, assembly, or other processing (including the incorporation of such property, as a component, into a second product by means of production, manufacture, or assembly) outside the United States by such person, then the property is for a foreign use.

[1523] In other words, the fact that a component is included in a piece of property that is eventually sold for a foreign use is insufficient for the sale of the component to be considered for a foreign use.

[1524] An S corporation's taxable income is computed in the same manner as an individual (sec. 1363(b)) so that deductions allowable only to corporations, such as FDII and GILTI, do not apply. See Report by the House Committee on Ways and Means to accompany H.R. 6055, Subchapter S Revision Act of 1982, H. Rep. No. 97–826, p. 14; and Report by the Senate Committee on Finance to accompany H.R. 6055, Subchapter S Revision Act of 1982, S. Rep. 97–640, p. 15.

- The Code provides that deductions for corporations provided in part VIII of subchapter B, which include the deduction for FDII and GILTI, do not apply in computing investment company taxable income (sec. 852(b)(2)(C)) or real estate investment trust taxable income (sec. 857(b)(2)(A)). Therefore, the deduction for FDII and GILTI does not apply to RICs or REITs.

[1525] Due to the reduction in the effective U.S. tax rate resulting from the deduction for FDII and GILTI, the conferees expect the Secretary to provide, as appropriate, regulations or other guidance similar to that under amended section 965 with respect to the determination of basis adjustments under section 705(a)(1) and the determination of gain or loss under section 986(c).

[1526] 13.125 percent equals the effective GILTI rate of 10.5 percent divided by 80 percent. If the foreign tax rate on GILTI is 13.125 percent, and domestic corporations are allowed a credit equal to 80 percent of foreign taxes paid, then the post-credit foreign tax rate on GILTI equals 10.5 percent (= 13.125 percent × 80 percent), which equals the effective GILTI rate of 10.5 percent. Therefore, no U.S. residual tax is owed.

[1527] If the foreign tax rate on GILTI is zero percent, then the U.S. residual tax rate on GILTI is 13.125 percent. Therefore, as foreign tax rates on GILTI range between zero percent and 16.406 percent, the total combined foreign and U.S. tax rate on GILTI ranges between 13.125 percent and 16.406 percent. At foreign tax rates greater than or equal to 16.406 percent, there is no residual U.S. tax on GILTI, and the combined foreign and U.S. tax rate on GILTI equals the foreign tax rate.

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 proposal 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 proposal 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 proposal to provide regulations and other guidance as may be necessary and appropriate to carry out the purposes of this proposal. 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.[1528] 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 proposal 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 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except with respect to certain conforming amendments.

CONFERENCE AGREEMENT

The conference agreement follows the House bill with the following modifications. The conference agreement applies the existing language of section 78, which treats the gross-up as a dividend to the domestic corporation, to foreign income taxes deemed paid under section 960(a), (b), and (d) (without regard to the phrase '80 percent of' in section 960(d)(1), except with respect to section 245 and new section 245A (i.e., the deemed dividend would not receive the benefit of the participation exemption). The conference agreement further revises new section 250(a)(1)(B) to apply the deduction with respect to inclusions under new section 951A to the section 78 gross-up.

In addition, the conference agreement eliminates the dividend reference in section 907(c)(3)(A) without disturbing the application of section 907(c)(3)(A) to certain interest payments. The conference agreement also amends section 1293(f) to provide section 960(a) credits to an inclusion of income of a qualified electing fund (as defined in section 1295) consistent with present law.

The conference agreement makes certain conforming amendments to sections 901(m), 904, 907, and 909, including replacing the reference to section 960(b) in section 904(k) to section 960(c), striking the reference to section 902 in section 904(d)(2)(E), and preserving the current applicability of sections 901(m) and 909 to all taxpayers who claim foreign tax credits, including qualified electing funds.

Effective date.—The provision applies to taxable years 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.

2. Source of income from sales of inventory determined solely on basis of production activities (sec. 4102 of the House bill, sec. 14304 of the Senate amendment, and sec. 863(b) of the Code)

HOUSE BILL

Under the 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.

SENATE AMENDMENT

The Senate amendment is identical to the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

3. Separate foreign tax credit limitation basket for foreign branch income (sec. 14302 of the Senate amendment and sec. 904 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

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

Under this provision, business profits of a QBU shall be determined under rules established by the Secretary. Business profits of a QBU shall not, however, include any income which is passive category income.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

4. Acceleration of election to allocate interest, etc., on a worldwide basis (sec. 14303 of the Senate amendment and sec. 864 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

This provision accelerates the effective date of the worldwide interest allocation rules to apply to taxable years beginning after December 31, 2017, rather than to taxable years beginning after December 31, 2020.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

D. Modification of Subpart F Provisions

1. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment (sec. 4201 of the House bill, sec. 14213 of the Senate amendment, and sec. 955 of the Code)

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment follows the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

2. Repeal of treatment of foreign base company oil related income as subpart F income (sec. 4202 of the House bill, sec. 14211 of the Senate amendment, and sec. 954(a) of the Code)

HOUSE BILL

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. shareholders in which or with which such taxable years of foreign corporations end.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

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.

3. Inflation adjustment of de minimis exception for foreign base company income (sec. 4203 of the House bill, sec. 14212 of the Senate amendment, and sec. 954(b)(3) of the Code)

HOUSE BILL

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 five 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

[1528] See Treas. Reg. sec. 1.904–6(a).

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment provision.

4. Look-thru rule for related controlled foreign corporations made permanent (sec. 4204 of the House bill, sec. 14217 of the Senate amendment, and sec. 954(c)(6) of the Code)

HOUSE BILL

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 proposal 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

Effective date.—The proposal 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.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment provision.

5. Modification of stock attribution rules for determining CFC status (sec. 4205 of the House bill, sec. 14214 of the Senate amendment, and secs. 318 and 958 of the Code)

HOUSE BILL

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.

It also conforms the reporting requirements of section 6038 to require that entities that are treated as CFCs by reason of the rules on constructive ownership are within the scope of the reporting requirements.

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 in which or with which such taxable years of foreign corporations end.

SENATE AMENDMENT

The Senate amendment is similar to the House bill, except that it does not adopt the change to the reporting requirements of section 6038 and has a different effective date. Furthermore, the Senate Finance Committee explanation states that the provision is not intended to cause a foreign corporation to be treated as a controlled foreign corporation with respect to a U.S. shareholder as a result of attribution of ownership under section 318(a)(3) to a U.S. person that is not a related person (within the meaning of section 954(d)(3)) to such U.S. shareholder as a result of the repeal of section 958(b)(4).[1529]

Effective date.—The provision is effective for the last taxable year of foreign corporations beginning before January 1, 2018 and each subsequent year of such foreign corporations and for the taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment. In adopting this provision, the conferees intend to render ineffective certain transactions that are used to as a means of avoiding the 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. Such a transaction converts former CFCs to non-CFCs, despite continuous ownership by U.S. shareholders.

Effective date.—The provision is effective for the last taxable year of foreign corporations beginning before January 1, 2018 and each subsequent year of such foreign corporations and for the taxable years of U.S. shareholders in which or with which such taxable years of foreign corporations end.

6. Modification of definition of United States shareholder (sec. 14215 of the Senate amendment and sec. 951 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

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

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.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

7. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply (sec. 4206 of the House bill, sec. 14216 of the Senate amendment, and sec. 951(a)(1) of the Code)

HOUSE BILL

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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

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.

8. Current year inclusion of foreign high return amounts or global intangible low-taxed income by United States shareholders (sec. 4301 of the House bill, sec. 14201 of the Senate amendment, and secs. 78 and 960 and new sec. 951A of the Code)

HOUSE BILL

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:[1530]

FHRA = Net CFC Tested Income – [(7% + AFR) × 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 certain exceptions to tested income, over deductions (including taxes) properly allocable to such gross income. The exceptions to tested income are: (1) the corporation's ECI if the income is subject to tax;[1531] (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

[1529] Committee Print, *Reconciliation Recommendations Pursuant to H. Con. Res. 71*, S. Prt. 115–20, (December 2017), p. 378, as reprinted on the website of the Senate Budget Committee, available at *https://www.budget.senate.gov/taxreform*.

[1530] If the amount of interest expense exceeds [(7% + AFR) × QBAI], then the quantity in brackets in the formula equals zero in the determination of FHRA.

[1531] ECI includes income that is subject to the election described in section 4303 of the House bill and new sec. 4491. 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 sec. 4491, to the extent that the sales are made to a related party.

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). Commodities income is intended to include any foreign oil and gas extraction income[1532] and any foreign oil related income.[1533]

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 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 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 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 earns foreign sales income of $300 and has deductions of $220 (= $20 of taxes plus $200 of operating expenses) 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 earns foreign sales income of $2,000 and has deductions of $385 (= $85 of taxes plus $300 of operating expenses) 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]).[1534]

[1532] Sec. 907(c)(1).

[1533] Sec. 907(c)(2).

[1534] The section 78 gross-up amount = 100 percent × 97.1 percent × $105 = 101.90.

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.

Example 2: Variant of Example 1, With Tested Loss

Example 2 generally has the same facts as example 1, except that CFC2 earns 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 6.25 percent (= FHRA/Aggregate Tested Income = $5/$80). 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 × 6.25 percent × $105 = $5.25.

US1 includes 50 percent of its FHRA in gross income and 50 percent of its section 78 gross-up in gross income, or $5.78 (= 50% × [$5 + $6.56]).[1535] 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 $5.78, or $1.16.

The residual U.S. tax paid by US1 on its FHRA is its tentative U.S. tax of $1.16 less its deemed-paid credit of $5.25, or $0. The amount of US1's deemed-paid credit that is unused, $4.09, 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 consists of 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.

SENATE AMENDMENT

In general

Under the provision, a U.S. shareholder of any CFC must include in gross income for a taxable year its global intangible low-taxed income (''GILTI'') in a manner generally similar to inclusions of subpart F income. GILTI means, with respect to any U.S. shareholder for the shareholder's taxable year, the excess (if any) of the shareholder's net CFC tested income over the shareholder's net deemed tangible income return. The shareholder's net deemed tangible income return is an amount equal to 10 percent 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.

The formula for GILTI, which is calculated at the U.S. shareholder level, is:

GILTI = Net CFC Tested Income – (10% × QBAI)

Net CFC tested income

Net CFC tested income means, with respect to any U.S. shareholder, the excess of the aggregate of the shareholder's 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 certain exceptions to tested income—over deductions (including taxes) properly allocable to such gross income (referred to in this document as ''tested gross income''). The exceptions to tested income are: (1) the corporation's ECI under section 952(b); (2) any gross income taken into account in determining the corporation's subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income (as defined in section 907(c)(1)).

The tested loss of a CFC means the excess (if any) of 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 average of the aggregate of its adjusted bases, determined as of the close of each quarter of the taxable year, in specified tangible property used in its trade or business and of a type with respect to which a deduction is generally allowable under section 167. The adjusted basis in any property must be determined using the alternative depreciation system under current section 168(g), notwithstanding any provision of law (or any other section of the Senate amendment) which is enacted after the date of enactment of this provision (unless such later enacted law specifically and directly amends this provision's definition).

Specified tangible property means any property used in the production of tested income.[1536] If such property was used in the production of both tested income and income that is not tested income (i.e., dual-use property), the property is treated as specified tangible property in the same proportion that the amount of tested gross income produced with respect to the property bears to the total amount of gross income produced with respect to the property.[1537]

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.

Coordination with subpart F

Although GILTI inclusions do not constitute subpart F income, GILTI inclusions are generally treated similarly to subpart F inclusions. Thus they are generally treated in the same manner as amounts included under section 951(a)(1)(A) for purposes of applying sections 168(h)(2)(B), 535(b)(10), 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). However, the Secretary may provide rules for coordinating the GILTI inclusion with provisions of law in which the determination of subpart F income is required to be made at the CFC level.

The provision requires that the amount of GILTI included by a U.S. shareholder be allocated across each CFC with respect to which it is a U.S. shareholder. The portion of GILTI treated as being with respect to a CFC equals zero for a CFC with no tested income and, for a CFC with tested income, the portion of GILTI which bears the same ratio to the total amount of GILTI as the U.S. shareholder's pro rata amount of tested income of the CFC bears to the aggregate amount of the U.S. shareholder's pro rata amount of the tested income of each CFC with respect to which it is a U.S. shareholder. For a CFC with tested income, the following formula expresses how to determine the portion of GILTI treated as being with respect to the CFC:

[1535] The section 78 gross-up amount = 100 percent × 6.25 percent × $105 = $6.56.

[1536] Specified tangible property does not include property used in the production of tested loss, so that a CFC that has a tested loss in a taxable year does not have QBAI for the taxable year.

[1537] For example, if a building produces $1,000 of tested gross income and $250 of subpart F income for a taxable year, then 80 percent (= $1,000/$1,250) of a domestic corporation's average adjusted basis in the building is included in QBAI for that taxable year.

$$CFC's\ GILTI = GILTI \times \left(Share\ of\ CFC's\ Tested\ Income \middle/ Share\ of\ Agg.\ CFC\ Tested\ Income \right)$$

where is the U.S. shareholder's pro rata amount of the tested income of a CFC and is the aggregate amount of the U.S. shareholder's pro rata amount of the tested income of each CFC with respect to which it is a U.S. shareholder.

For purposes of the GILTI inclusion, a person is treated as a U.S. shareholder of a CFC for any taxable year only if such person owns (within the meaning of section 958(a)) stock in the corporation on the last day, in such year, 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.

Deemed-paid credit for taxes properly attributable to tested income

For any amount of GILTI included in the gross income of a domestic corporation, the corporation's deemed-paid credit equals 80 percent of the product of the corporation's inclusion percentage multiplied by the aggregate tested foreign income taxes paid or accrued, with respect to tested income, by each CFC with respect to which the domestic corporation is a U.S. shareholder.

The inclusion percentage means, with respect to any domestic corporation, the ratio (expressed as a percentage) of such corporation's GILTI amount 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 (referred to as "aggregate tested income" in the formulas below). Tested foreign income taxes means, with respect to any domestic corporation that is a U.S. shareholder of a CFC, the foreign income taxes paid or accrued by the CFC that are properly attributable to the CFC's tested income.[1538]

The deemed-paid credit with respect to the GILTI inclusion can be expressed in the following formula:

$$Deemed\text{-}Paid\ Credit = 80\% \times \frac{GILTI}{Aggregate\ Tested\ Income} \times Aggregate\ Tested\ Foreign\ Income\ Tax$$

The provision creates a separate foreign tax credit basket for GILTI, with no carryforward or carryback available for excess credits. For purposes of determining the foreign tax credit limitation, GILTI is not general category income, and income that is both GILTI and passive category income is considered passive category income. As described in section 14301 of the Senate amendment and new section 78, the taxes deemed to have been paid are treated as an increase in GILTI for purposes of section 78, determined by taking into account 100 percent of the product of the inclusion percentage and aggregate tested foreign income taxes (instead of 80 percent in the determination of the deemed-paid credit). Therefore, the section 78 gross-up can be expressed in the following formula:

$$Section\ 78\ Gross\text{-}Up = 100\% \times \frac{GILTI}{Aggregate\ Tested\ Income} \times Aggregate\ Tested\ Foreign\ Income\ Tax$$

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.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment provision, with clarifications and modifications that include the following.

Net deemed tangible income return

The conference agreement modifies, along lines similar to an approach taken in the House bill provision, the calculation of net deemed tangible income return for purposes of determining GILTI. Net deemed tangible income return is, with respect to any U.S. shareholder for a taxable year, the excess (if any) of 10 percent of the aggregate of its pro rata share of the QBAI of each CFC with respect to which it is a U.S. shareholder over the amount of interest expense taken into account in determining its net CFC tested income for the taxable year to the extent that the interest expense exceeds the interest income properly allocable to the interest expense that is taken into account in determining its net CFC tested income. As a result, the formula for GILTI in the conference agreement is generally:[1539]

GILTI = Net CFC Tested Income—[(10% × QBAI)—Interest Expense]

where *Interest Expense* is defined and limited in the manner described above.

Computation of tested income and tested loss

For purposes of computing deductions (including taxes) properly allocable to gross income included in tested income or tested loss with respect to a CFC, the deductions are allocated to such gross income following rules similar to the rules of section 954(b)(5) (or to which such deductions would be allocable if there were such gross income).

Calculation of pro rata shares

For purposes of determining pro rata shares in the computation of a U.S. shareholder's GILTI amount, a person is treated as a U.S. shareholder of a CFC for any taxable year of such person only if the person owns (within the meaning of section 958(a)) stock in the foreign corporation on the last day in the taxable year of the foreign corporation on which the foreign corporation is a CFC.

Qualified business asset investment

For purposes of determining a CFC's QBAI and its adjusted basis in specified tangible property, the adjusted basis is determined by allocating the depreciation deduction with respect to the property ratably to each day during the period in the taxable year to which the depreciation relates. In addition, if a CFC holds an interest in a partnership at the close of the CFC's taxable year, the CFC 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 the 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 167, and is used in the production of tested income (determined with respect to the CFC's distributive share of income with respect to the property). The CFC's distributive share of the adjusted basis of any property is the CFC's distributive share of income with respect to the property.

Regulatory authority to address abuse

The conferees intend that non-economic transactions intended to affect tax attributes of CFCs and their U.S. shareholders (including amounts of tested income and tested loss, tested foreign income taxes, net deemed tangible income return, and QBAI) to minimize tax under this provision be disregarded. For example, the conferees expect the Secretary to prescribe regulations to address transactions that occur after the measurement date of post-1986 earnings and profits under amended section 965, but before the first taxable year for which new section 951A applies, if such transactions are undertaken to increase a CFC's QBAI.

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.

9. Limitation on deduction of interest by domestic corporations which are members of an international group (sec. 4302 of the House bill, sec. 14221 of the Senate amendment, and new sec. 163(n) of the Code)

HOUSE BILL

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

[1538] Tested foreign income taxes do not include any foreign income tax paid or accrued by a CFC that is properly attributable to the CFC's tested loss (if any).

[1539] If the amount of interest expense exceeds 10% × QBAI, then the quantity in brackets in the formula equals zero in the determination of GILTI.

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,[1540] 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.

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.

SENATE AMENDMENT

For any domestic corporation that is a member of a worldwide affiliated group (hereinafter referred to as the ''U.S. corporate members''), the provision reduces the deduction for interest paid or accrued by the corporation by the product of the net interest expense of the domestic corporation multiplied by the debt-to-equity differential percentage of the worldwide affiliated group. Net interest expense means the excess (if any) of: (1) interest paid or accrued by the taxpayer during the taxable year, over (2) the amount of interest includible in the gross income of the taxpayer for the taxable year.[1541]

A worldwide affiliated group is one or more chains of corporations, connected through stock ownership with a common parent that would qualify as an affiliated group under section 1504(a), with two differences. First, the ownership threshold of section 1504(a)(2) is applied using 50 percent rather than 80 percent. Second, the restrictions on inclusion described in sections 1504(b)(2), (b)(3) and (b)(4) are disregarded for purposes of identifying the worldwide affiliated group.

The debt-to-equity differential percentage means, with respect to any worldwide affiliated group, the excess domestic indebtedness of the group divided by the total indebtedness of the domestic corporations that are members of the group. All U.S. corporate members of the worldwide affiliated group are treated as one member when determining whether the group has excess domestic indebtedness as a result of a debt-to-equity differential. Excess domestic indebtedness is the amount by which the total indebtedness of the U.S. corporate members exceeds 110 percent of the total indebtedness those members would hold if their total indebtedness to total equity ratio equaled the ratio of total indebtedness to total equity for the worldwide affiliated group. Total equity means, with respect to one or more corporations, the excess (if any) of: (1) the money and all other assets of such corporations, over (2) the total indebtedness of such corporations. For purposes of this computation, intragroup debt and equity interests are disregarded, and assets of the U.S. corporate members of the worldwide affiliated group exclude any interest held by any U.S. corporate member in any foreign corporation that is a member of the group.

The amount of any interest not allowed as a deduction for any taxable year by reason of this provision or new section 163(j) (depending on whichever imposes the lower limitation with respect to such taxable year) can be carried forward indefinitely.

The Secretary is provided regulatory authority to provide rules for: (1) the prevention of the avoidance of this provision, (2) adjustments in the case of corporations which are members of an affiliated group as may be appropriate to carry out the purposes of the provision, (3) the coordination of this provision with section 884, (4) the treatment of partnership indebtedness, allocation of partnership debt, interest, or distributive shares, and (5) the coordination of this provision with new section 163(j).

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment provision.

E. Prevention of Base Erosion

1. Base erosion using deductible cross-border payments between affiliated companies (sec. 4303 of the House bill and new secs. 4491 and 6038E of the Code; sec. 14401 of the Senate amendment and secs. 6038A and 6038C and new secs. 59A and 59B of the Code)

HOUSE BILL

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

[1540] 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.

[1541] The Secretary is provided is regulatory authority to provide for adjustments in determining the amount of net interest expense.

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[1542] if the average 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:

$$(GEBIT - USEBIT + RPOP - RPIP) \div (GREV - USREV + RPOP)$$

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 US to FS1, $112.50 would be deemed to be income effectively connected to a US 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.

[1542] 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.

Effective date.—The provisions of this section apply to amounts paid or incurred after December 31, 2018.

SENATE AMENDMENT

In general

Under the provision, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. The base erosion minimum tax amount is the excess of 10 percent of the modified taxable income of the taxpayer for the taxable year over an amount equal to the regular tax liability (defined in section 26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess of an amount equal to the credits allowed under Chapter 1 less the credit allowed under section 38 (general business credits) for the taxable year allocable to the research credit under section 41(a). For taxable years beginning after December 31, 2025, two changes are made, (A) the 10-percent provided for above is changed to 12.5-percent, and (B) the regular tax liability is reduced by the aggregate amount of the credits allowed under Chapter 1 (and no other adjustment is made).[1543]

To determine its modified taxable income, the applicable taxpayer computes its taxable income for the year without regard to any base erosion tax benefit of a base erosion payment or base erosion percentage of any allowable net operating loss deduction.

Base erosion payments

A base erosion payment generally includes any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable under Chapter 1. Such payments also include any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation).

Base erosion payments do not include payments for cost of goods sold (which is not a deduction but rather a reduction to income). A base erosion payment includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, but only if such person first became a surrogate foreign corporation after November 9, 2017, or (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2), but does not include a foreign corporation treated as a domestic corporation under section 7874(b).

A base erosion payment does not apply to any amount paid or accrued by a taxpayer for services if such services meet the requirements for eligibility for use of the services cost method under section 482,[1544] determined without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure and such amount constitutes the total services cost with no markup.

Any qualified derivative payment is not treated as a base erosion payment. A qualified derivative payment means any payment made by a taxpayer pursuant to a derivative with respect to which the taxpayer: (i) recognizes gain or loss as if such derivative were sold for its fair market value on the last business day of the taxable year (and such additional times as are required by this title or the taxpayer's method of accounting), (ii) treats any gain or loss so recognized as ordinary, and (iii) treats the character of all items of income, deduction, gain or loss with respect to a payment pursuant to the derivative as ordinary.

No payment is treated as a qualified derivative payment unless the taxpayer includes in the information required to be reported under section 6038B(b)(2) with respect to such taxable year such information as is necessary to identify the payments to be so treated and such other information as the Secretary of the Treasury determines necessary to carry out the provision.

The rule for qualified derivative payments does not apply if such payment would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment, or in the case of a contract which has derivative and nonderivative components, the payment is properly allocable to the nonderivative component.

For these purposes, the term derivative means any contract (including any option, forward contract, futures contract, short position, swap, or similar contract) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to one or more of the following: (i) any share of stock of a corporation, (ii) any evidence of indebtedness, (iii) any commodity which is actively traded, (iv) any currency, (v) any rate, price, amount, index, formula, or algorithm. Except as otherwise provided by the Secretary of the Treasury, American depository receipts and similar instruments with respect to shares of stock in foreign corporations are treated as shares of stock in such foreign corporations.

A base erosion tax benefit means: (i) any deduction allowed under Chapter 1 for the taxable year with respect to a base erosion payment, (ii) in the case of a base erosion payment with respect to the purchase of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation), any deduction allowed in Chapter 1 for depreciation or amortization in lieu of depreciation with respect to the property acquired with such payment, or (iii) any reduction in gross receipts with respect to a payment described above with respect to a surrogate foreign corporation (as defined there) in computing gross income of the taxpayer for the taxable year.

Any base erosion tax benefit attributable to any base erosion payment on which tax is imposed by sections 871 or 881 and with respect to which tax has been deducted and withheld under sections 1441 or 1442, is not taken into account in computing modified taxable income as defined above. The amount not taken into account in computing modified taxable income is reduced under rules similar to the rules under section 163(j)(5)(B).[1545]

The base erosion percentage means for any taxable year, the percentage determined by dividing the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year by the aggregate amount of the deductions allowable to the taxpayer under Chapter 1 for the taxable year, taking into account base erosion tax benefits described above and by not taking into account any deduction allowed under sections 172, 245A or 250 for the taxable year.

Applicable taxpayers and related parties

Applicable taxpayer means with respect to any taxable year, a taxpayer: (A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (B) the average annual gross receipts of the corporation for the three-taxable-year period ending with the preceding taxable year are at least $500 million, and (C) the base erosion percentage (as defined above) of the corporation for the taxable year is four percent or higher.

In the case of a foreign person the gross receipts of which are taken into account for purposes of this provision, only gross receipts which are taken into account in determining income effectively connected with the conduct of a trade or business within the United States is taken into account. If a foreign person's gross receipts are aggregated with a U.S. person's gross receipts for reasons described in the aggregation rules below, the preceding sentence does not apply to the gross receipts of any U.S. person which are aggregated with the taxpayer's gross receipts.

All persons treated as a single employer under section 52(a) are treated as one person for purposes of this provision, except that in applying section 1563 for purposes of section 52, the exception for foreign corporations under section 1563(b)(2)(C) is disregarded (called the ''aggregation rules'').

For purposes of this provision, foreign person has the meaning given in section 6038A(c)(3).

Related party means: (i) any 25-percent owner of the taxpayer, (ii) any person who is related to the taxpayer or any 25-percent owner of the taxpayer, within the meaning of sections 267(b) or 707(b)(1), and (iii) any other person related to the taxpayer within the meaning of section 482. For these purposes, section 318 regarding constructive ownership of stock applies to these related party rules except that 10-percent is substituted for 50-percent in section 318(a)(2)(C), and for these purposes section 318(a)(3)(A), (B) and (C) do not cause a United States person to own stock owned by a person who is not a United States person.

The provision provides that the Secretary of the Treasury is to prescribe such regulations or other guidance necessary or appropriate, including regulations providing for such adjustments to the application of this section necessary to prevent avoidance of the provision, including through: (1) the use of unrelated persons, conduit transactions, or other intermediaries, or (2) transactions or arrangements designed in whole or in part: (A) to characterize payments otherwise subject to this provision as payments not subject to this provision, or (B) to substitute payments not subject to this provision for payments otherwise subject to this provision.

Information reporting requirements[1546]

The provision authorizes the Secretary of the Treasury to prescribe additional reporting requirements under section 6038A relating to: (A) the name, principal place of business, and country or countries in which organized or resident of each person which: (i) is

[1543] In the case of an applicable taxpayer that is a member of an affiliated group (defined in section 1504(a)(1)) that includes a bank as defined in section 581 or a registered securities dealer defined in section 15(a) of the Securities Exchange Act of 1934, the rates are 11 percent instead of the abovementioned 10 percent and 13.5 percent instead of the abovementioned 12.5 percent.

[1544] Described in Treas. Reg. sec. 1.482–9(b).

[1545] As in effect before the date of enactment of Tax Cuts and Jobs Act.

[1546] Section 15006 of the bill (and new section 6050Z) establishes certain reporting requirements. These reporting requirements are effective for taxable years beginning after December 31, 2024, and continue to be required regardless of whether the revenue requirement is met. Any taxpayer who makes a payment to a foreign person who is a related party (as such term is defined in section 14401 of the bill and new section 59A) of the taxpayer during the taxable year is required to make a return, according to forms and regulations prescribed by the Secretary, setting forth (1) the amount of such payments by type and separately stated and (2) any amount paid a related party to the reporting corporation, and (ii) had any transaction with the reporting corporation during its taxable year, (B) the manner of relation between the reporting corporation and the person referred to in (A), and (C) transactions between the reporting corporation and each related foreign person.

In addition, for purposes of information reporting under sections 6038A and 6038C, if the reporting corporation or the foreign corporation to which section 6038C applies is an applicable taxpayer under this provision, the information that may be required includes: (A) base erosion payments paid or accrued during the taxable year by the taxpayer to a foreign person which is a related party of the taxpayer, (B) such information as the Secretary of the Treasury finds necessary to determine the base erosion minimum amount of the taxpayer for the taxable year, and (C) such other information as the Secretary of the Treasury determines is necessary.

The penalties provided for under sections 6038A(D)(1) and (2) are both increased to $25,000.

Effective date.—The provision applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The provision in the conference agreement follows the Senate amendment with some changes, as follows.

In general

Under the provision, an applicable taxpayer is required to pay a tax equal to the base erosion minimum tax amount for the taxable year. The base erosion minimum tax amount is the excess of 10 percent[1547] of the modified taxable income of the taxpayer for the taxable year over an amount equal to the regular tax liability (defined in section 26(b)) of the taxpayer for the taxable year reduced (but not below zero) by the excess (if any) of the credits allowed under Chapter 1 against such regular tax liability over the sum of: (1) the credit allowed under section 38 for the taxable year which is properly allocable to the research credit determined under section 41(a), plus (2) the portion of the applicable section 38 credits not in excess of 80 percent of the lesser of the amount of such credits or the base erosion minimum tax amount (determined without regard to this clause (2)). For taxable years beginning after December 31, 2025, two changes are made, (A) the 10-percent provided for above is changed to 12.5-percent, and (B) the regular tax liability is reduced by the aggregate amount of the credits allowed under Chapter 1 (and no other adjustment is made).[1548]

Applicable section 38 credits means the credit allowed under section 38 for the taxable year which is properly allocable to: (A) the low-income housing credit determined under section 42(a), (B) the renewable electricity production credit determined under section 45(a), and (C) the investment credit determined under section 46, but only to the extent properly allocable to the energy credit determined under section 48.

To determine its modified taxable income, the applicable taxpayer computes its taxable income for the year without regard to any base erosion tax benefit with respect to any base erosion payment or the base erosion percentage of any allowable net operating loss deduction allowed under section 172 for the taxable year.

Base erosion payments

A base erosion payment means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable under Chapter 1. Such payments include any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation). A base erosion payment includes any premium or other consideration paid or accrued by the taxpayer to a foreign person which is a related party of the taxpayer for any reinsurance payments taken into account under sections 803(a)(1)(B) or 832(b)(4)(A).

Base erosion payments do not include any amount that constitutes reductions in gross receipts including payments for costs of goods sold. However, base erosion payment includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, but only if such person first became a surrogate foreign corporation after November 9, 2017, or (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2), but does not include a foreign corporation treated as a domestic corporation under section 7874(b).

A base erosion payment does not include any amount paid or accrued by a taxpayer for services if such services meet the requirements for eligibility for use of the services cost method described in Treas. Reg. sec. 1.482–9, as in effect as of the date of enactment of TCJA, without regard to the requirement that the services not contribute significantly to fundamental risks of business success or failure and only if the payments are made for services that have no markup component.

Any qualified derivative payment is not treated as a base erosion payment. A qualified derivative payment means any payment made by a taxpayer pursuant to a derivative with respect to which the taxpayer: (i) recognizes gain or loss as if such derivative were sold for its fair market value on the last business day of the taxable year (and such additional times as are required by this title or the taxpayer's method of accounting), (ii) treats any gain or loss so recognized as ordinary, and (iii) treats the character of all items of income, deduction, gain or loss with respect to a payment pursuant to the derivative as ordinary.

No payment is treated as a qualified derivative payment unless the taxpayer includes in the information required to be reported under section 6038B(b)(2) with respect to such taxable year such information as is necessary to identify the payments to be so treated and such other information as the Secretary of the Treasury determines necessary to carry out the provision.

The rule for qualified derivative payments does not apply if a payment with respect to a derivative is in substance, or is disguising, the kind of payment that would be treated as a base erosion payment if it were not made pursuant to a derivative, including any interest, royalty, or service payment, (or any other payment subject to this provision) or in the case of a contract which has derivative and nonderivative components, the payment is properly allocable to the nonderivative component.

For these purposes, the term derivative means any contract (including any option, forward contract, futures contract, short position, swap, or similar contract) the value of which, or any payment or other transfer with respect to which, is (directly or indirectly) determined by reference to one or more of the following: (i) any share of stock of a corporation, (ii) any evidence of indebtedness, (iii) any commodity which is actively traded, (iv) any currency, (v) any rate, price, amount, index, formula, or algorithm. Except as otherwise provided by the Secretary of the Treasury, American depository receipts and similar instruments with respect to shares of stock in foreign corporations are treated as shares of stock in such foreign corporations. The term derivative does not include any item described in paragraphs (i) through (v) above nor shall the term 'derivative' include any insurance, annuity, or endowment contract issued by an insurance company to which subchapter L applies (or issued by any foreign corporation to which such subchapter would apply if such foreign corporation were a domestic corporation).

A base erosion tax benefit means: (i) any deduction allowed under Chapter 1 for the taxable year with respect to a base erosion payment, (ii) in the case of a base erosion payment with respect to the purchase of property of a character subject to the allowance for depreciation (or amortization in lieu of depreciation), any deduction allowed in Chapter 1 for depreciation or amortization in lieu of depreciation with respect to the property acquired with such payment, or (iii) any reduction in gross receipts with respect to a payment described above with respect to a surrogate foreign corporation (as defined there) in computing gross income of the taxpayer for the taxable year.

Any base erosion tax benefit attributable to any base erosion payment on which tax is imposed by sections 871 or 881 and with respect to which tax has been deducted and withheld under sections 1441 or 1442, is not taken into account in computing modified taxable income as defined above. The amount not taken into account in computing modified taxable income is reduced under rules similar to the rules under section 163(j)(5)(B).[1549]

The base erosion percentage means for any taxable year, the percentage determined by dividing the aggregate amount of base erosion tax benefits of the taxpayer for the taxable year by the aggregate amount of the deductions allowable to the taxpayer under Chapter 1 for the taxable year, taking into account base erosion tax benefits described above and by not taking into account any deduction allowed under sections 172, 245A or 250 for the taxable year, any deduction for amounts paid or accrued for services to which the exception for the services cost method (as described above) applies, and any deduction for qualified derivative payments which are not treated as a base erosion payment as described above.

Applicable taxpayers and related parties

Applicable taxpayer means with respect to any taxable year, a taxpayer: (A) which is a corporation other than a regulated investment company, a real estate investment trust, or an S corporation; (B) the average annual gross receipts of the corporation for the three-taxable-year period ending with the preceding taxable year are at least $500 million, and (C) the base erosion percentage (as defined above) of the corporation for the taxable year is three percent or higher.[1550]

that results in a reduction of gross receipts to the taxpayer (e.g., cost of goods sold).

[1547] 5 percent rate applies for one year for base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

[1548] In the case of a taxpayer that is a member of an affiliated group (defined in section 1504(a)(1)) that includes a bank as defined in section 581 or a registered securities dealer defined in section 15(a) of the Securities Exchange Act of 1934, the rates are 6 percent instead of 5 percent, 11 percent instead of 10 percent and 13.5 percent instead of 12.5 percent.

[1549] As in effect before the date of enactment of TCJA.

[1550] In the case of an applicable taxpayer that is a member of an affiliated group (defined in section

Continued

In the case of a foreign person the gross receipts of which are taken into account for purposes of this provision, only gross receipts which are taken into account in determining income effectively connected with the conduct of a trade or business within the United States is taken into account. If a foreign person's gross receipts are aggregated with a U.S. person's gross receipts for reasons described in the aggregation rules below, the preceding sentence does not apply to the gross receipts of any U.S. person which are aggregated with the taxpayer's gross receipts.

All persons treated as a single employer under section 52(a) are treated as one person for purposes of this provision, except that in applying section 1563 for purposes of section 52, the exception for foreign corporations under section 1563(b)(2)(C) is disregarded (called the ''aggregation rules'').

For purposes of this provision, foreign person has the meaning given in section 6038A(c)(3).

Related party means: (i) any 25-percent owner of the taxpayer, (ii) any person who is related to the taxpayer or any 25-percent owner of the taxpayer, within the meaning of sections 267(b) or 707(b)(1), and (iii) any other person related to the taxpayer within the meaning of section 482. For these purposes, section 318 regarding constructive ownership of stock applies to these related party rules except that 10-percent is substituted for 50-percent in section 318(a)(2)(C), and for these purposes section 318(a)(3)(A), (B) and (C) do not cause a United States person to own stock owned by a person who is not a United States person.

The provision provides that the Secretary of the Treasury is to prescribe such regulations or other guidance necessary or appropriate, including regulations providing for such adjustments to the application of this section necessary to prevent avoidance of the provision, including through: (1) the use of unrelated persons, conduit transactions, or other intermediaries, or (2) transactions or arrangements designed in whole or in part: (A) to characterize payments otherwise subject to this provision as payments not subject to this provision, or (B) to substitute payments not subject to this provision for payments otherwise subject to this provision.

Information reporting requirements [1551]

The provision authorizes the Secretary of the Treasury to prescribe additional reporting requirements under section 6038A relating to: (A) the name, principal place of business, and country or countries in which organized or resident of each person which: (i) is a related party to the reporting corporation, and (ii) had any transaction with the reporting corporation during its taxable year, (B) the manner of relation between the reporting corporation and the person referred to in (A), and (C) transactions between the reporting corporation and each related foreign person.

In addition, for purposes of information reporting under sections 6038A and 6038C, if the reporting corporation or the foreign corporation to which section 6038C applies is an applicable taxpayer under this provision, the information that may be required includes: (A) base erosion payments paid or accrued during the taxable year by the taxpayer to a foreign person which is a related party of the taxpayer, (B) such information as the Secretary of the Treasury finds necessary to determine the base erosion minimum amount of the taxpayer for the taxable year, and (C) such other information as the Secretary of the Treasury determines is necessary.

The penalties provided for under sections 6038A(D)(1) and (2) are both increased to $25,000.

Effective date.—The provision applies to base erosion payments paid or accrued in taxable years beginning after December 31, 2017.

2. Limitations on income shifting through intangible property transfers (sec. 14222 of the bill and secs. 367, 482, and 936 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision addresses recurring definitional and methodological issues that have arisen in controversies [1552] in transfers of intangible property for purposes of sections 367(d) and 482, both of which use the statutory definition of intangible property in section 936(h)(3)(B). The provision revises that definition and confirms the authority to require certain valuation methods. It does not modify the basic approach of the existing transfer pricing rules with regard to income from intangible property.

Under the provision, workforce in place, goodwill (both foreign and domestic), and going concern value are intangible property within the meaning of section 936(h)(3)(B), as is the residual category of ''any similar item'' the value of which is not attributable to tangible property or the services of an individual. The flush language at the end of that subparagraph is removed, to make clear that the source or amount of value is not relevant to whether property that is one of the specified types of intangible property is within the scope of the definition.

The provision clarifies the authority of the Secretary to specify the method to be used to determine the value of intangible property, both with respect to outbound restructurings of U.S. operations and to intercompany pricing allocations,[1553] by amending 482 as well as the grant of regulatory authority under section 367 regarding the use of aggregate basis valuation and the application of the realistic alternative principle.

With respect to aggregate basis valuation, the provision requires use of that method of valuation in the case of transfers of multiple intangible properties in one or more related transactions if the Secretary determines that an aggregate basis achieves a more reliable result than an asset-by-asset approach. The provision is consistent with the position that the additional value that results from the interrelation of intangible assets can be properly attributed to the underlying intangible assets in the aggregate, where doing so yields a more reliable result. This approach is also consistent with Tax Court decisions in cases outside of the section 482 context, where collections of multiple, related intangible assets were viewed by the Tax Court in the aggregate.[1554] Finally, it is also consistent with the cost-sharing regulations.[1555]

The provision codifies use of the realistic alternative principles to determine valuation with respect to intangible property transactions. The realistic alternative principle is predicated on the notion that a taxpayer will only enter into a particular transaction if none of its realistic alternatives is economically preferable to the transaction under consideration. For example, under the existing regulations provide the IRS with the ability to determine an arm's-length price by reference to a transaction (such as the owner of intangible property using it to make a product itself) that is different from the transaction that was actually completed (such as the owner of that same intangible property licensing the manufacturing rights and then buying the product from the licensee).

Effective date.—The provision applies to transfers in taxable years beginning after December 31, 2017. No inference is intended with respect to application of section 936(h)(3)(B) or the authority of the Secretary to provide by regulation for such application with respect to taxable years beginning before January 1, 2018.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

3. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities (sec. 14223 of the Senate amendment and sec. 267A of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity. A disqualified related party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes or is subject to tax, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country. A disqualified related party amount does not include any payment to the extent such payment is included in the gross income of a U.S. shareholder under

1504(a)(1)) that includes a bank as defined in section 581 or a registered securities dealer defined in section 15(a) of the Securities Exchange Act of 1934, the base erosion percentage of which is two percent or higher.

[1551] Section 15006 of the bill (and new section 6050Z) establishes certain reporting requirements. These reporting requirements are effective for taxable years beginning after December 31, 2024, and continue to be required regardless of whether the revenue requirement is met. Any taxpayer who makes a payment to a foreign person who is a related party (as such term is defined in section 14401 of the bill and new section 59A) of the taxpayer during the taxable year is required to make a return, according to forms and regulations prescribed by the Secretary, setting forth (1) the amount of such payments by type and separately stated and (2) any amount paid that results in a reduction of gross receipts to the taxpayer (*e.g.*, cost of goods sold).

[1552] *Veritas v. Commissioner*, 133 T.C. No. 14 (December 10, 2009), *non-acq.*, IRB 2010–49 (December 6, 2010). (stating that including goodwill and going concern value within the definition would ''expand[]'' that definition, and that ''taxpayers are merely required to be compliant, not prescient''); *Amazon v. Commissioner*, 148 T.C. No. 8 (2017) (holding that ''workforce in place, going concern value, goodwill, and what trial witnesses described as 'growth options' and corporate 'resources' or 'opportunities' '' all fell outside the definition under present law).

[1553] Secs. 367(d) and 482.

[1554] *See, e.g., Kraft Foods Co. v. Commissioner*, 21 T.C. 513 (1954) (thirty-one related patents must be valued as a group and the useful life for depreciation should be based on the average of the patents' useful lives); *Standard Conveyor Co. v. Commissioner*, 25 B.T.A. 281, p. 283 (1932) (''[I]t is evident that it is impossible to value these seven patents separately. Their value, as in the case of many groups of patents representing improvements on the prior art, appears largely to consist of their combination.''); *Massey-Ferguson, Inc. v. Commissioner*, 59 T.C. 220 (1972) (taxpayer who abandoned a distribution network of contracts with separate distributorships was entitled to an abandonment loss for the entire network in the taxable year during which the last of the contracts was terminated because that was the year in which the entire intangible value was lost).

[1555] See Treas. Reg. sec. 1.482–7(g)(2)(iv) (if multiple transactions in connection with a cost-sharing arrangement involve platform, operating and other contributions of resources, capabilities or rights that are reasonably anticipated to be interrelated, then determination of the arm's-length charge for platform contribution transactions and other transactions on an aggregate basis may provide the most reliable measure of an arm's-length result).

section 951(a). A related party for these purposes is determined under the rules of section 954(d)(3), except that such section applies with respect to the payor as opposed to the CFC otherwise referred to in such section.

A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for Federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax. A hybrid entity is any entity which is either: (1) treated as fiscally transparent for Federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for Federal income tax purposes.

The provision further provides that the Secretary shall issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of the provision, including regulations or other guidance providing rules for: (1) denying deductions for conduit arrangements that involve a hybrid transaction or a hybrid entity, (2) the application of this provision to foreign branches, (3) applying this provision to certain structured transactions, (4) denying all or a portion of a deduction claimed for an interest or a royalty payment that, as a result of the hybrid transaction or entity, is included in the recipient's income under a preferential tax regime of the country of residence of the recipient and has the effect of reducing the country's generally applicable statutory tax rate by at least 25 percent, (5) denying all of a deduction claimed for an interest or a royalty payment if such amount is subject to a participation exemption system or other system which provides for the exclusion or deduction of a substantial portion of such amount, (6) rules for determining the tax residence of a foreign entity if the foreign entity is otherwise considered a resident of more than one country or of no country, (7) exceptions to the general rule set forth in the provision, and (8) requirements for record keeping and information in addition to any requirements imposed by section 6038A.

Effective date.—The provision shall apply to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with the following modifications. The bill provides that the Secretary shall issue regulations or other guidance as may be necessary or appropriate to carry out the purposes of the provision for branches (domestic or foreign) and domestic entities, even if such branches or entities do not meet the statutory definition of a hybrid entity.

4. Shareholders of surrogate foreign corporations not eligible not eligible for reduced rate on dividends (sec. 14225 of the Senate amendment and sec. 1 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

Any individual shareholder who receives a dividend from a corporation which is a surrogate foreign corporation as defined in section 7874(a)(2)(B), other than a foreign corporation which is treated as a domestic corporation under section 7874(b), is not entitled to the lower rates on qualified dividends provided for in section 1(h).

Effective date.—The provision is effective for dividends paid in taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with a modification. The modification is that the provision applies to dividends received from foreign corporations that first become surrogate foreign corporations after date of enactment.

Effective date.—The provision is effective for dividends received after date of enactment.

F. 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 (sec. 4401 of the House 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[1556] 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[1557] 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.[1558] Wages paid to bona fide residents of Puerto Rico generally are not included in the definition of wages for purposes of computing the wage limitation amount.[1559]

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.[1560] 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.[1561] 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.[1562]

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.

HOUSE BILL

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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

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 House bill and sec. 7652(f) of the Code)

PRESENT LAW

A $13.50 per proof gallon[1563] excise tax is imposed on distilled spirits produced in or imported into the United States.[1564] 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 U.S. Virgin Islands).[1565]

The Code provides for cover over (payment) to Puerto Rico and the U.S. Virgin Islands of the excise tax imposed on rum imported (or brought) into the United States, without regard to the country of origin.[1566] The amount of the cover over is limited under section 7652(f) to the lesser of (1) $10.50 per proof gallon ($13.25 per proof gallon before January 1, 2017) or (2) the excise tax imposed under section 5001(a)(1) on each proof gallon.

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 U.S. Virgin Islands are covered over to the U.S. Virgin Islands. Tax amounts attributable to shipments to the United States of rum produced in neither Puerto Rico nor the U.S.

[1556] Qualifying production property generally includes any tangible personal property, computer software, and sound recordings.

[1557] 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.

[1558] 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.

[1559] Section 3401(a)(8)(C) excludes wages paid to U.S. citizens who are bona fide residents of Puerto Rico from the term wages for purposes of income tax withholding.

[1560] Sec. 7701(a)(9).

[1561] Sec. 199(d)(8)(A).

[1562] Sec. 199(d)(8)(B).

[1563] A proof gallon is a liquid gallon consisting of 50 percent alcohol. See secs. 5002(a)(10) and (11).

[1564] Sec. 5001(a)(1).

[1565] Secs. 5214(a)(1)(A), 5002(a)(15), 7653(b) and (c).

[1566] 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 U.S. Virgin Islands is retained by the United States under section 7652(b)(3).

Virgin Islands are divided and covered over to the two possessions under a formula.[1567] Amounts covered over to Puerto Rico and the U.S. Virgin Islands are deposited into the treasuries of the two possessions for use as those possessions determine.[1568] All of the amounts covered over are subject to the limitation.

HOUSE BILL

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 U.S. 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.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

3. Extension of American Samoa economic development credit (sec. 4403 of the House 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 13, 1995, and (2) the corporation elected the benefits of the possession tax credit[1569] in an election in effect for its taxable year that included October 13, 1995.[1570] 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 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.

HOUSE BILL

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[1571] 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 the House bill.

Effective date.—The provision is effective for taxable years beginning after December 31, 2016.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill provision.

G. Other International Reforms

1. Restriction on insurance business exception to the passive foreign investment company rules (sec. 4501 of the House bill, sec. 14502 of the Senate amendment, and sec. 1297 of the Code)

PRESENT LAW

Passive foreign investment companies.

The Tax Reform Act of 1986[1572] 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.[1573] 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.[1574] 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.[1575] 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.''[1576]

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.[1577] In applying the insurance exception,

[1567] Secs. 7652(e)(2).

[1568] Secs. 7652(a)(3), (b)(3), and (e)(1).

[1569] 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.

[1570] 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.

[1571] Tax Relief and Health Care Act of 2006, Pub. L. No. 109–432, sec. 119.

[1572] Pub. L. No. 99–514.

[1573] Sec. 1297.

[1574] Secs. 1293–1295.

[1575] Sec. 1291.

[1576] Sec. 1296

[1577] Sec. 1297(b)(2)(B).

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 terms of the contracts, and the status of the company as an insurance company.[1578]

HOUSE BILL

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.[1579] 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 mean, with respect to any property and casualty or life insurance business (1) loss and loss adjustment expenses, (2) 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. 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.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

Effective date.—The provision applies to taxable years beginning after December 31, 2017.

2. Repeal of fair market value of interest expense apportionment (sec. 14503 of the Senate amendment and sec. 864 of the Code)

HOUSE BILL

No provision.

SENATE AMENDMENT

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

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

Effective date.—The provision is effective for taxable years beginning after December 31, 2017.

3. Modification to source rules involving possessions (sec. 14504 of the Senate amendment and sec. 865 of the Code)

PRESENT LAW

In general

The U.S. Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands have income tax systems that "mirror" the U.S. Code, with the latter two possessions being permitted under current law to delink and use their own tax systems provided certain conditions are met. The U.S. Virgin Islands may also impose certain local income taxes in addition to taxes imposed by the mirror Code. The Code provides rules for coordination of United States and U.S. Virgin Islands taxation.[1580] It permits the U.S. Virgin Islands to reduce or remit tax otherwise imposed by the mirror code if the tax is attributable to U.S. Virgin Islands source income or income effectively connected to the conduct of a trade or business in U.S. Virgin Islands.[1581] The U.S. Virgin Islands has exercised that authority to provide development incentives for certain types of businesses operating within its borders. Under such initiatives, companies can receive a 90 percent reduction in their tax liability on certain income.

Taxation of individuals

Under the mirror Code, U.S. Virgin Islands citizens and residents are taxable on their worldwide income. A foreign tax credit is allowed for income taxes paid to the United States, foreign countries, and other possessions of the United States. In general, a bona fide resident of the U.S. Virgin Islands is required to file and pay tax only to the possession; compliance with that obligation satisfies any Federal income tax filing obligation. All other U.S. residents or citizens with income from U.S. Virgin Island sources are subject to a dual filing requirement.

In the case of an individual who is a U.S. citizen or alien residing in the United States or the U.S. Virgin Islands, only one tax is computed under the Code. If an individual is a bona fide resident of U.S. Virgin Islands for the entire taxable year, such tax is payable to the U.S. Virgin Islands and no U.S. tax is imposed. Otherwise, a citizen or resident of the United States who has income from

[1578] 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.

[1579] 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.*

[1580] Secs. 932 and 934.

[1581] Sec. 934. In general, a bona fide resident of the U.S. Virgin Islands is required to file and pay tax only to the possession. Persons incurring income tax liability in both the United States and the U.S. Virgin Islands are required to file tax returns and pay income tax to both jurisdictions.

sources within the U.S. Virgin Islands must determine the portion of income attributable to the U.S. Virgin Islands and the related tax payable to the U.S. Virgin Islands. The remaining portion is payable to the United States.[1582]

Concerns that U.S. citizens not resident in the U.S. Virgin Islands were improperly claiming residence in the U.S. Virgin Islands[1583] or forming entities in the U.S. Virgin Islands in order to recharacterize income earned in the United States as sourced in the U.S. Virgin Islands and claim the 90 percent economic development credit led to legislative changes in 2004.[1584] These changes provided a definition of bona fide residence in a possession and rules to determine source of income from possessions. They also impose a requirement that individuals report any change in residency status with respect to a possession during a taxable year.[1585]

Taxation of corporations

If a corporation is formed in U.S. Virgin Islands, it is classified as a domestic corporation for U.S. Virgin Islands purposes and a foreign corporation for U.S. tax purposes. Such a corporation is only subject to U.S. tax if it has U.S.-source income or income effectively connected with the conduct of a trade or business in the United States. U.S. Virgin Islands taxes a domestic corporation on its worldwide income, but the company is allowed a foreign tax credit against U.S. Virgin Islands tax for taxes imposed by the United States, foreign countries and other possessions. A corporation that is not formed in U.S. Virgin Islands is treated as a foreign corporation under the U.S. Virgin Islands mirror Code. A company not formed in U.S. Virgin Islands is only subject to U.S. Virgin Islands tax if it has U.S. Virgin Islands source income or income effectively connected with the conduct of a trade or business in U.S. Virgin Islands. The United States taxes its domestic corporations on their worldwide income, but allows a foreign tax credit for taxes imposed by foreign jurisdictions, including U.S. Virgin Islands.

Sourcing rules

As a general rule, the principles for determining whether income is U.S. source are applicable for purposes of determining whether income is possession source. In addition, the principles for determining whether income is effectively connected with the conduct of a U.S. trade or business are applicable for purposes of determining whether income is effectively connected to the conduct of a possession trade or business. However, except as provided in regulations, any income treated as U.S. source income or as effectively connected with the conduct of a U.S. trade or business is not treated as income from within any possession or as effectively connected with a trade or business within any such possession.[1586] This rule applies regardless of where the office or fixed place of business connected to such trade or business is located.

Section 865(j)(3) was added by the Technical and Miscellaneous Revenue Act of 1988 (''TAMRA''),[1587] and states that Treasury is authorized to waive the requirements imposed by sections 865(e)(1)(B) and 865(g)(2) (both of which impose a 10 percent foreign tax requirement for source treatment of sales of personal property) for the purposes of determining Guam, American Samoa, Commonwealth of the Northern Mariana Islands, and Puerto Rico-source income (sections 931 and 933, respectively).

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision modifies the sourcing rule in section 937(b)(2) by modifying the U.S. income limitation to exclude only U.S. source (or effectively connected) income attributable to a U.S. office or fixed place of business. The provision also modifies section 865(j)(3) by providing Treasury with the authority to waive the 10% foreign tax requirement for source treatment of capital gains income earned by a U.S. Virgin Islands resident.

Effective date.—The provision shall apply to taxable years beginning after December 31, 2018.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

TITLE II

Section 20001. Oil and Gas Program

Section 20001 directs the Secretary of the Interior to establish and administer all aspects of a competitive oil and gas program in the non-wilderness portion of the Arctic National Wildlife Refuge, known as the ''1002 Area'' or Coastal Plain. The legislation defines the term ''Coastal Plain'' by referencing Plate 1 and Plate 2 of the October 24, 2017 Map prepared by the United States Geological Survey.

The legislation repeals the prohibition on development from the Coastal Plain contained in section 1003 of the Alaska National Interest Lands Conservation Act (16 U.S.C. 3143), and directs the Secretary to manage the oil and gas program on the Coastal Plain in a manner similar to what is required by the Naval Petroleum Reserves Production Act of 1976 (42 U.S.C. 6501 et seq.). The legislation sets a 16.67 percent royalty rate for leases and allocates 50 percent of the revenue derived from the program to the State of Alaska, with the remainder going to the Federal Treasury.

Section 20001 further requires the Secretary to conduct at least two area-wide lease sales within the 10-year budget window—the first lease sale within four years of the Act's enactment and the second lease sale within seven years of enactment. Each lease sale must contain not fewer than 400,000 acres and be comprised of those areas that have the highest hydrocarbon potential.

The legislation directs the Secretary to issue any necessary rights-of-way or easements across the Coastal Plain for the exploration, development, production, or transportation associated with the oil and gas program. Additionally, the section authorizes the development of up to 2,000 surface acres of federal land on the Coastal Plain.

Section 20002. Limitations on Amount of Distributed Qualified Outer Continental Shelf Revenues

Section 20002 temporarily increases the annual limitation on offshore revenue sharing under section 105(f)(1) of the Gulf of Mexico Energy Security Act of 2006 (Public Law 109–432) for the states of Alabama, Louisiana, Mississippi, and Texas from $500 million annually for FY 2020 and FY 2021, to $650 million annually for those two fiscal years.

Section 20003. Strategic Petroleum Reserve Drawdown and Sale

Section 20003 directs the Secretary of Energy to draw down and sell a total of seven million barrels of crude oil from the Strategic Petroleum Reserve during FY 2026 through FY 2027. The section prohibits the Secretary from taking actions that would limit the President's authority to direct a drawdown and sale of petroleum products to address a domestic or international energy supply shortage pursuant to section 161(h) of the Energy Policy and Conservation Act (42 U.S.C. 6241). The Secretary is further directed to stop the drawdown or sale of crude oil after the date on which a total of $600 million has been deposited in the general fund of the Federal Treasury.

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.

TAX COMPLEXITY ANALYSIS

Section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998 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 Code and has widespread applicability to individuals or small businesses. The staff of the Joint Committee on Taxation has determined that the following provisions are of widespread applicability to individuals or small businesses.

1. Temporary modification of tax rates, tax brackets, standard deduction and repeal of personal exemptions (secs. 11001, 11002, 11021 and 11041 of the bill)

Summary description of the provisions

The bill temporarily changes the structure of the individual income tax by modifying the rate structure such that the tax brackets are 10-percent, 12-percent, 22-percent, 24-percent, 32-percent, 35-percent and 37-percent. The bill temporarily increases the size of the standard deduction (for 2018 the standard deduction is $24,000 for joint filers, $18,000 for heads of household and $12,000 for other filers), and temporarily eliminates personal exemptions. These provisions sunset for taxable years beginning after December 31, 2025.

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.

[1582] Sec. 932(b). See, Internal Revenue Service, *Tax Guide for Individuals with Income from U.S. Possessions* (Pub. 570), 2011, pp. 17–18.

[1583] In Notice 2004–45, 2004–2 C.B. 33 (2004), the IRS described several scenarios in which U.S. persons claimed to have satisfied U.S. liabilities by having filed a return with the U.S. Virgin Islands.

[1584] *McHenry v. Commissioner*, 2012 U.S. App. LEXIS 7562 (April 16, 2012) and *Huff v. Commissioner*, 135 T.C. 605 (2010).

[1585] Sec. 937. In the preamble to final regulations issued in 2008, certain *de minimis* exceptions are provided for the U.S. citizen or resident with income from U.S. Virgin Island sources, in recognition that ''the interaction of section 937 and other sections of the Code relating to the territories requires a balance between implementing the policies Congress intended in section 937(b) while recognizing the territories' efforts to retain and attract workers and businesses.'' T.D. 9391, 73 F.R. 19350 (April 9, 2008); Treas. Reg. Sec. 1.937–2. Those required to report changes in residency status must use Form 8898, ''Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession.''

[1586] 1586 Sec. 937(b).

[1587] Pub. L. No. 100–647.

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).

The IRS will need to modify its forms and publications. The temporary nature of the provision will necessitate that the IRS do this again once the temporary provisions expire.

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. Temporary deduction for qualified business income (sec. 11011 of the bill)

Summary description of the provisions

For taxable years beginning after December 31, 2017 and before January 1, 2026, an individual taxpayer generally may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of aggregate qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income. Special rules apply to specified agricultural or horticultural cooperatives permitting the cooperative a deduction.

A limitation based on the greater of 50 percent of W–2 wages paid, or the sum of 25 percent of W–2 wages paid plus a capital allowance, is phased in above a threshold amount of taxable income. A disallowance of the deduction with respect to specified service trades or businesses is also phased in above the same threshold amount of taxable income. The threshold amount is $157,500 (twice that amount or $315,000 in the case of a joint return), indexed. These limitations are fully phased in for a taxpayer with taxable income in excess of the threshold amount plus $50,000 ($100,000 in the case of a joint return).

Qualified business income for a taxable year generally means the net amount of domestic qualified items of income, gain, deduction, and loss with respect to the taxpayer's qualified businesses. Qualified business income does not include any amount paid by an S corporation that is treated as reasonable compensation of the taxpayer. Similarly, qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business, and to the extent provided in regulations, does not include any amount allocated or distributed by a partnership to a partner who is acting other than in his or her capacity as a partner for services. Qualified business income or loss does not include certain investment-related income, gain, deductions, or loss.

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 the 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 business income and how to apply the phaseins of the W–2 wage (or W–2 wage and capital) limit and of the exclusion of service business income in the case of taxpayers with taxable income exceeding the threshold amount of $157,500 (twice that amount or $315,000 in the case of a joint return), indexed. This increased volume of questions could have an adverse impact on other elements of IRS's 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 business income, as well as the phaseins. This worksheet will require a series of calculations.

3. Temporary increase in child tax credit (sec. 11022 of the bill)

Summary description of the provisions

The bill temporarily increases the value of the child tax credit to $2,000, providing that no more than $1,400 per child shall be refundable. This $1,400 limitation is indexed for inflation. In order to qualify for the child tax credit, a Social Security number must be provided for the qualifying child for whom such credit is claimed. These provisions sunset for taxable years beginning after December 31, 2025.

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. The temporary nature of the provision will necessitate that the IRS do this again once the temporary provision expires.

4. Temporary suspension of the deduction for State and local income taxes (sec. 11042 of the bill)

Summary description of the provisions

The bill provides that 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. 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).

Under the bill, in the case of an individual, State and local income, war profits, and excess profits taxes are not allowable as a deduction.

The bill contains an exception to the above-stated rule. Under the provision a taxpayer may claim an itemized deduction of up to $10,000 ($5,000 for married taxpayer filing a separate return) for the aggregate of (i) State and local property taxes not paid or accrued in carrying on a trade or business, or an activity described in section 212, and (ii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income, etc. taxes) paid or accrued in the taxable year. Foreign real property taxes may not be deducted under this exception.

The above rules apply to taxable years beginning after December 31, 2017, and beginning before January 1, 2026.

The bill also provides that, in the case of an amount paid in a taxable year beginning before January 1, 2018, with respect to a State or local income tax imposed for a taxable year beginning after December 31, 2017, the payment shall be treated as paid on the last day of the taxable year for which such tax is so imposed for purposes of applying the provision limiting the dollar amount of the deduction. Thus, under the provision, an individual may not claim an itemized deduction in 2017 on a pre-payment of income tax for a future taxable year in order to avoid the dollar limitation applicable for taxable years beginning after 2017.

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.

The IRS will need to modify its forms and publications to reflect this change. The temporary nature of the provision will necessitate that the IRS do this again once the temporary provision expires.

5. Modifications of rules for expensing depreciable business assets (sec. 13101 of the bill)

The bill increases the maximum amount a taxpayer may expense under section 179 to $1,000,000, and increases the phase-out threshold amount to $2,500,000. The $1,000,000 and $2,500,000 amounts, as well as the $25,000 sport utility vehicle limitation, are indexed for inflation for taxable years beginning after 2018.

The bill expands the definition of section 179 property to include certain depreciable tangible personal property used predominantly to furnish lodging or in connection with furnishing lodging.

The bill also expands the definition of qualified real property eligible for section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.

The bill applies to property placed in service in taxable years beginning after December 31, 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.

6. Temporary 100-percent expensing for certain business assets (sec. 13201 of the bill)

The bill extends and modifies the additional first-year depreciation deduction through 2026 (through 2027 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. Thus, the bill follows the present-law phase-down of bonus depreciation for property acquired before September 28, 2017, and placed in service after September 27, 2017. The 100-percent allowance is phased down by 20 percent per calendar year for property placed in service, and specified plants planted or grafted, in taxable years beginning after 2022 (after 2023 for longer production period property and certain aircraft).

The bill removes the requirement that the original use of qualified property must commence with the taxpayer (*i.e.*, it allows the additional first-year depreciation deduction for new and used property).

As a conforming amendment to the repeal of corporate AMT, the election to accelerate AMT credits in lieu of bonus depreciation is repealed.

The bill maintains the section 280F increase amount of $8,000 for passenger automobiles placed in service after December 31, 2017. However, the bill follows the present-law phase-down of the section 280F increase amount in the limitation on the depreciation deduction allowed with respect to certain passenger automobiles 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, 2027 (January 1, 2028, in the case of longer production period property).

The bill expands the definition of qualified property eligible for the additional first-year depreciation allowance to include qualified film, television and live theatrical productions (as defined in section 181(d) and (e)) for which a deduction otherwise would have been allowable under section 181 without regard to the dollar limitation or termination of such section, effective for productions placed in service after September 27, 2017, and before January 1, 2027. For purposes of this provision, a production is considered placed in service at the time of initial release, broadcast, or live staged performance (i.e., at the time of the first commercial exhibition, broadcast, or live staged performance of a production to an audience).

The bill excludes from the definition of qualified property any property which is primarily used in 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, by a public service or public utility commission or other similar body of any State or political subdivision thereof, or by the governing or ratemaking body of an electric cooperative.

The bill excludes from the definition of qualified property any property used 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 prohibited from using the cash method and is exempt from the interest limitation rules by meeting a small business $25 million gross receipts test.

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.

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VERY PRELIMINARY
15-Dec-17

**ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1,
THE "TAX CUTS AND JOBS ACT"**

Fiscal Years 2018 - 2027

[Billions of Dollars]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
I. Individual Tax Reform													
A. Simplification and Reform of Rates, Standard Deductions, and Exemptions													
1. 10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets (sunset 12/31/25) [1][2]............................	tyba 12/31/17	-94.1	-135.3	-140.9	-146.4	-152.0	-158.1	-164.3	-171.1	-52.0	[3]	-668.7	-1,214.2
2. Modify standard deduction ($12,000 for singles, $24,000 for married filing jointly, $18,000 for HoH) (sunset 12/31/25) [2]..	tyba 12/31/17	-57.2	-82.6	-84.7	-87.5	-90.7	-92.9	-95.7	-99.1	-30.0	[3]	-402.6	-720.4
3. Repeal of deduction for personal exemptions (sunset 12/31/25) [2]..	generally tyba 12/31/17	93.3	137.1	141.6	146.4	151.8	157.6	163.3	169.2	51.3	---	670.1	1,211.5
4. Alternative inflation measure [2]...	tyba 12/31/17	0.8	2.1	5.5	8.2	10.4	12.8	16.6	20.0	25.6	31.5	27.0	133.5
B. Treatment of Business Income of Individuals, Trusts, and Estates													
1. Allow 20 percent deduction of qualified business income and certain dividends for individuals and for gross income of agricultural or horticultural cooperatives (sunset 12/31/25) [4]..	generally tyba 12/31/17	-27.7	-47.1	-49.9	-51.8	-52.8	-52.2	-53.6	-53.2	-24.2	-1.9	-229.5	-414.5
2. Disallow active passthrough losses in excess of $500,000 for joint filers, $250,000 for all others (sunset 12/31/25).....	tyba 12/31/17	9.5	16.2	17.2	18.0	18.8	19.6	20.4	19.4	9.3	1.3	79.7	149.7
C. Reform of the Child Tax Credit													
1. Modification of child tax credit: $2,000 not indexed; refundable up to $1,400 indexed down to nearest $100 base year 2018; $2,500 refundability threshold not indexed; $500 other dependents not indexed; phase outs $200K/$400K not indexed (sunset 12/31/25) [2].................	tyba 12/31/17	-29.3	-67.7	-69.2	-70.4	-71.4	-73.8	-74.9	-76.0	-40.7	---	-308.1	-573.4
2. Require valid Social Security number of each child to claim refundable and non-refundable portions of child credit, non-child dependents and any child without a valid Social Security number still receives $500 non-refundable credit (sunset 12/31/25) [2]..	tyba 12/31/17	---	3.9	3.8	3.8	3.7	3.8	3.7	3.7	3.0	0.5	15.2	29.8

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
D. Simplification and Reform of Deductions and Exclusions													
1. Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to $10,000 in State and local taxes), interest on mortgage debt in excess of $750K, interest on home equity debt, non-disaster casualty losses, and certain miscellaneous expenses (sunset 12/31/25) [2].........	generally tyba 12/31/17	43.5	70.4	72.0	77.1	82.3	87.9	94.0	100.2	41.1	---	345.3	668.4
2. Increase percentage limit for charitable contributions of cash to public charities (sunset 12/31/25).........	cmi tyba 12/31/17	---------- *Estimate Included in Item I.D.1.* ----------											
3. Repeal of overall limitation on itemized deductions (sunset 12/31/25).........	tyba 12/31/17	---------- *Estimate Included in Item I.D.1.* ----------											
4. Repeal exclusion for employer-provided bicycle commuter fringe benefit (sunset 12/31/25).........	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	---	[5]	[5]
5. Repeal exclusion for employer-provided qualified moving expense reimbursements (other than members of the Armed Forces) (sunset 12/31/25) [6][7].........	tyba 12/31/17	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.7	0.2	---	2.7	4.8
6. Repeal of deduction for moving expenses (other than members of the Armed Forces) (sunset 12/31/25).........	tyba 12/31/17	0.6	0.8	0.9	0.9	1.0	1.0	1.0	1.1	0.3	---	4.1	7.6
7. Limitation on wagering losses (sunset 12/31/25).........	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	---	0.1	0.1
E. Retirement Savings													
1. Repeal of special rule permitting recharacterization of Roth conversions.........	tyba 12/31/17	[5]	[5]	[5]	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
2. Length of service awards for public safety volunteers [8].........	tyba 12/31/17	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
3. Extended rollover period for certain plan loan offsets.........	tyba 12/31/17	---------- *Negligible Revenue Effect* ----------											
F. Double Estate, Gift, and GST Tax Exemption Amount (sunset 12/31/25).........	dda & gma 12/31/17	-1.2	-8.1	-8.8	-9.1	-9.6	-10.1	-10.7	-11.1	-11.0	-3.3	-36.8	-83.0
G. Increase the Individual AMT Exemption Amounts and Phase-out Thresholds (sunset 12/31/25).........	tyba 12/31/17	-6.9	-82.5	-69.9	-74.9	-80.5	-81.6	-85.6	-90.1	-65.2	[3]	-314.7	-637.1
H. Reduce ACA Individual Shared Responsibility Payment Amount to Zero [2][9][10].........	mba 12/31/18	---	6.0	9.7	28.4	37.0	40.7	43.5	46.1	49.6	53.3	80.8	314.1
I. Other Provisions													
1. Restore a medical expense deduction for expenses in excess of 7.5 percent of adjusted gross income (sunset 12/31/18).........	tyba 12/31/16	-3.8	-1.4	---	---	---	---	---	---	---	---	-5.2	-5.2
2. Allow for increased contributions to ABLE accounts; allow saver's credit for ABLE contributions (sunset 12/31/25).........	tyba DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
3. Allow rollovers from 529 accounts to ABLE accounts (sunset 12/31/25).........	da DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
4. Extend time limit for contesting IRS levy	[11]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
5. Treatment of certain individuals performing services in the Sinai Peninsula of Egypt (sunset 12/31/25)	spo/a 6/9/15	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	---	[3]	[3]
6. Treatment of student loans discharged on account of death or disability (sunset 12/31/25)	doia 12/31/17	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1
7. Allow 529 withdrawals up to $10,000 for primary and secondary education	da 12/31/17	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
8. Retirement plan and casualty loss relief for any area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Relief and Emergency Assistance Act during 2016	DOE	-3.2	-1.3	[5]	[5]	[3]	[3]	[3]	[3]	[3]	[3]	-4.6	-4.6
9. Repeal of deduction for alimony payments and corresponding inclusion in income	generally dosaeia 12/31/18	---	0.1	0.2	0.4	0.5	0.7	0.9	1.1	1.4	1.7	1.2	6.9
Total of Individual Tax Reform		**-75.3**	**-188.8**	**-171.9**	**-156.3**	**-150.8**	**-144.0**	**-140.9**	**-139.2**	**-41.4**	**83.0**	**-744.0**	**-1,126.6**
II. Business Tax Reform													
A. Repeal of Alternative Minimum Tax on Corporations [2]	tyba 12/31/17	-6.8	-6.9	-6.6	-6.8	-7	-1.3	-1.3	-1.3	-1.2	-1.1	-34.0	-40.3
B. 21 Percent Corporate Tax Rate	tyba 12/31/17	-101.3	-125.3	-130.5	-131.1	-132.6	-136.2	-140.7	-144.7	-149.7	-156.3	-620.8	-1,348.5
C. Small Business Reforms													
1. Increase section 179 expensing to $1 million with a phaseout range beginning at $2.5 million and expand definition of qualified property	ppisi tyba 12/31/17	-4.7	-7.4	-4.1	-2.6	-2.0	-1.5	-1.0	-0.9	-0.9	-0.9	-20.8	-25.9
2. Simplified accounting for small business	[12]	-7.6	-7.5	-3.3	-2.1	-1.7	-1.5	-1.6	-1.7	-1.7	-1.8	-22.1	-30.5
D. Cost Recovery, etc.													
1. Extension, expansion, and phase down of bonus depreciation (sunset 12/31/26) [13]	paa 9/27/17 apisasd & sppoga 9/27/17	-32.5	-36.5	-24.6	-14.2	-11.6	-4.9	3.3	8.4	12.5	13.7	-119.4	-86.3
2. Limit net interest deductions to 30 percent of adjusted taxable income, carryforward of denied deduction	tyba 12/31/17	8.4	17.7	19.7	19.6	24.9	30.2	29.6	31.8	34.7	36.9	90.2	253.4
3. Modify treatment of S corporation conversions into C corporations	DOE	-0.5	-0.5	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-2.8	-6.1
4. Modifications to depreciation limitations on luxury automobiles and personal use property	ppisa 12/31/17	*Estimate Included in Item II.D.1.*											
5. Modifications of treatment of certain farm property	ppisa 12/31/17	[3]	[3]	[3]	-0.1	-0.2	-0.3	-0.2	-0.1	[3]	[3]	-0.4	-1.1
6. Modification of net operating loss deduction	lai tyba 12/31/17	6.4	10.0	11.1	15.9	25.2	34.1	36.0	30.2	20.8	11.4	68.5	201.1
7. Repeal like-kind exchanges except for real property	generally eca 12/31/17	0.5	0.9	1.3	1.7	2.2	2.9	3.8	4.7	5.8	7.2	6.6	31.0
8. Applicable recovery period for real property	ppisa 12/31/17	-0.1	-0.1	-0.3	-0.4	-0.5	-0.7	-0.6	-0.7	-0.9	-0.6	-1.4	-4.9
9. Amortization of research and experimental expenditures	apoii tyba 12/31/21	---	---	---	---	24.2	32.9	26.0	18.9	11.4	6.3	24.2	119.7
10. Expensing of certain costs of replacing citrus plants lost by reason of a casualty (sunset 12/22/27)	apoia DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
E. Business-Related Deductions													
1. Repeal of deduction for income attributable to domestic production activities	tyba 12/31/17	4.3	8.9	9.3	9.6	9.9	10.3	10.7	11.1	11.6	12.2	42.1	98.0
2. Limitation on deduction by employers of expenses for fringe benefits:													
a. Meals and entertainment expenses, including meals for the convenience of the employer [14]	apoia 12/31/17 & apoia 12/31/25	1.6	2.2	2.2	2.3	2.3	2.4	2.4	2.5	2.8	2.8	10.6	23.5
b. Repeal deduction for qualified transportation fringes, including commuting except as necessary for employee's safety [15]	apoia 12/31/17	1.2	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	8.1	17.7
c. Clarification of tangible personal property deductible as employee achievement award	apoia 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
3. Eliminate deduction for member of Congress living expenses	tyba DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
4. UBTI increased by amount of certain fringe benefit expenses for which deduction is disallowed	apoia 12/31/17	*Estimate Included in Items II.E.2.b.*											
5. Repeal of rollover of publicly traded securities gain into specialized small business investment companies	sa 12/31/17	0.1	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	1.1	1.7
6. Certain self-created property not treated as a capital asset	Da 12/31/17	[3]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
F. Accounting Methods													
1. Certain special rules for taxable year of inclusion (in general)	tyba 12/31/17	1.2	1.7	1.7	1.7	0.7	0.2	0.2	0.2	0.2	0.2	7.0	8.1
2. Certain special rules for taxable year of inclusion (related to original issue discount and other similar items)	[16]	---	0.3	0.7	0.7	0.7	0.7	0.7	0.4	0.2	0.2	2.4	4.5
G. Business Credits													
1. Modification of credit for clinical testing expenses for certain drugs for rare diseases or conditions	apoii tyba 12/31/17	0.7	1.7	2.1	2.5	3.0	3.5	4.0	4.5	5.0	5.5	10.0	32.5
2. Modify rehabilitation credit to provide 20 percent historic credit ratably over 5 years, repeal credit for pre-1936 property	[17]	[5]	0.3	0.6	0.6	0.5	0.3	0.2	0.2	0.2	0.2	2.0	3.1
3. Provide a tax credit to certain employers who provide family and medical leave (sunset 12/31/19)	tyba 12/31/17	-0.7	-1.5	-1.1	-0.5	-0.3	-0.2	---	---	---	---	-4.1	-4.3
H. Banks and Financial Instruments													
1. Limitation on deduction for FDIC premiums	tyba 12/31/17	0.5	1.5	1.5	1.5	1.5	1.6	1.6	1.6	1.7	1.7	6.5	14.8
2. Repeal of advance refunding bonds	ar bia 12/31/17	0.4	1.1	1.4	1.7	2.0	2.1	2.1	2.2	2.2	2.2	6.6	17.4
3. Repeal of tax credit bonds [2]	bia 12/31/17	[5]	[5]	[5]	[5]	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.5
I. Compensation													
1. Modification of limitation on excessive employee remuneration, with transition rule [18]	tyba 12/31/17	[5]	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.1	4.1	9.2

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
2. 21-percent excise tax on excess tax-exempt organization executive compensation (certain exceptions provided to non-highly compensated employees, and for certain medical services)	tyba 12/31/17	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.8
3. Treatment of qualified equity grants	[19]	-0.2	-0.2	-0.2	-0.2	-0.1	[3]	[3]	[3]	[3]	-0.1	-1.0	-1.2
4. Increase the excise tax on stock compensation in an inversion from 15 percent to 20 percent	DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1
J. Insurance													
1. Net operating losses of life insurance companies	lai tyba 12/31/17	*Estimate Included in Item II.D.6*											
2. Repeal of small life insurance company deduction	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.2
3. Adjustment for change in computing reserves	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.5	1.2
4. Repeal of special rule for distributions to shareholders from pre-1984 policyholders surplus account	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
5. Modification of proration rules for property and casualty insurance companies	tyba 12/31/17	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.0	2.1
6. Repeal of special estimated tax payments	tyba 12/31/17	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
7. Computation of life insurance reserves	tyba 12/31/17	0.9	1.7	1.7	1.7	1.8	1.8	1.8	1.9	1.2	0.6	7.9	15.2
8. Modification of rules for life insurance proration	tyba 12/31/17	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.6
9. Capitalization of certain policy acquisition expenses	tyba 12/31/17	0.1	0.4	0.6	0.7	0.7	0.8	0.9	0.9	1.0	1.1	2.5	7.2
10. Tax reporting for life settlement transactions	generally tyba 12/31/17	[3]	[3]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.1	[5]	0.2
11. Clarification of tax basis of life insurance contracts	generally teia 8/25/09	*Estimate Included in Item II.J.8.*											
12. Exception to transfer for valuable consideration rules	ta 12/31/17	*Estimate Included in Item II.J.8.*											
13. Modification of property and casualty insurance company discounting rules	tyba 12/31/17	0.3	1.8	1.8	1.8	1.8	1.8	1.7	1.4	0.6	0.3	7.5	13.2
K. Partnerships													
1. Tax gain on the sale of a partnership interest on look-thru basis	seado/a 11/27/17 & seada 12/31/17	[5]	0.2	0.3	0.3	0.4	0.5	0.5	0.5	0.5	0.6	1.2	3.8
2. Expand the definition of substantial built-in loss for purposes of partnership loss transfers	topia 12/31/17	[3]	[3]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.5
3. Charitable contributions and foreign taxes taken into account in determining limitation on allowance of partner's share of loss	tyba 12/31/17	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.2
4. Repeal of technical termination of partnerships	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	1.6
L. Tax-Exempt Organizations													
1. Excise tax based on investment income of private colleges and universities with endowment per student of at least $500,000	tyba 12/31/17	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.8
2. Unrelated business taxable income separately computed for each trade or business activity	generally tyba 12/31/17	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	1.6	3.5

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
3. Charitable deduction not allowed for amounts paid in exchange for college athletic event seating rights................	cmi tyba 12/31/17	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	2.0
4. Repeal substantiation exception for charitable contributions reported by donee organization......................	cmi tyba 12/31/16	----- *Negligible Revenue Effect* -----											
M. Other Provisions													
1. Modify tax treatment of Alaska Native Corporations and Settlement Trusts..	[20]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1
2. Expansion of qualifying beneficiaries of an electing small business trust, and modify charitable contribution deduction for electing small business trusts.........................	1/1/18 feoqb & tyba 12/31/17 fc	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.3
3. Craft beverage modernization and tax reform (sunset 12/31/19)..	generally 1/1/18	-1.6	-1.5	-1.1	---	---	---	---	---	---	---	-4.2	-4.2
4. Exempt amounts paid for aircraft management services from the excise taxes imposed on transportation by air........	apa DOE	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
5. Create qualified opportunity zones......................................	DOE	-1.2	-1.7	-1.6	-1.7	-1.6	-1.5	-1.5	-1.6	8.1	2.7	-7.7	-1.6
6. Deny deduction for settlements subject to a nondisclosure agreement paid in connection with sexual harassment..........	apoia DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]
7. Expand provision relating to the non-deductibility of fines and penalties...	apoio/a DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1	0.1
8. Repeal of deduction for local lobbying expenses.................	apoio/a DOE	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.8
9. Revision of treatment of contributions to capital.................	[21]	0.1	0.2	0.4	0.7	1.0	1.0	0.9	0.8	0.7	0.6	2.5	6.5
10. Recharacterization of certain gains on property held for fewer than 3 years in the case of partnership profits interest held in connection with performance of investment services..	tyba 12/31/17	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7	1.1
Total of Business Tax Reform...		**-129.3**	**-133.8**	**-112.9**	**-92.5**	**-50.4**	**-16.4**	**-15.9**	**-24.1**	**-28.4**	**-49.4**	**-518.2**	**-653.8**
III. International Tax Reform													
A. Establishment of Participation Exemption System for Taxation of Foreign Income													
1. Deduction for dividends received by domestic corporations from certain foreign corporations....................	[22]	-17.8	-28.1	-20.1	-20.3	-20.8	-21.0	-22.1	-23.2	-24.3	-25.8	-107.2	-223.6
2. Special rules relating to sales or transfers involving certain foreign corporations..	da 12/31/17 & Ta 12/31/17	0.1	0.2	0.5	0.8	1.2	1.4	1.7	1.6	1.8	2.4	2.9	11.8
3. Treatment of deferred foreign income upon transition to participation exemption system of taxation and mandatory inclusion at two-tier rate (8-percent rate for illiquid assets, 15.5-percent rate for liquid assets)...........	[23]	78.6	49.6	16.5	15.6	15.7	27.2	47.5	64.4	33.0	-9.4	176.0	338.8

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
B. Rules Related to Passive and Mobile Income													
1. Current year inclusion of global intangible low-taxed income, with deduction, by United States shareholders........	tyba 12/31/17 [24]	7.7	12.5	9.6	9.5	9.3	9.0	9.2	9.3	15.1	21.2	48.6	112.4
2. Deduction for foreign-derived intangible income derived from trade or business within the United States...................	tyba 12/31/17	-0.2	4.8	6.9	6.6	0.2	-11.4	-15.7	-20.2	-18.4	-16.3	18.2	-63.8
C. Other Modifications of Subpart F Provisions													
1. Elimination of inclusion of foreign base company oil related income..	[24]	-0.1	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.7	-1.4	-4.0
2. Repeal of inclusion based on withdrawal of previously excluded subpart F income from qualified investment.........	[24]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]
3. Modification of stock attribution rules for determining status as a controlled foreign corporation............................	[25]	Estimate Included in Item III.A.1.											
4. Modification of definition of United States shareholder.......	[24]	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.7	1.3
5. Elimination of requirement that corporation must be controlled for 30 days before subpart F inclusions apply......	[24]	[5]	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.6
D. Prevention of Base Erosion													
1. Limitation on income shifting through intangible property transfers..	ti tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.3
2. Certain related party amounts paid or accrued in hybrid transactions or with hybrid entities...........................	tyba 12/31/17	Estimate Included in Item III.A.1.											
3. Dividends received from post-enactment surrogate foreign corporations not qualified dividend income.........................	dra DOE	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	[5]	0.1
E. Modifications Related to Foreign Tax Credit System													
1. Repeal of section 902 indirect foreign tax credits; determination of section 960 credit on current year basis..	[24]	Estimate Included in Item III.A.1.											
2. Separate foreign tax credit limitation basket for foreign branch income...	tyba 12/31/17	Estimate Included in Item III.B.1.											
3. Source of income from sales of inventory determined solely on basis of production activities...............................	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.3	0.5
4. Increase maximum overall domestic loss recapture to 100 percent for pre-2018 losses..	tyba 12/31/17	-0.6	-1.1	-1.0	-0.6	0.1	0.4	0.1	0.1	0.1	0.1	-3.2	-2.3
F. Inbound Provisions													
1. Base erosion and anti-abuse tax..	apoaa 12/31/17	0.8	4.3	13.3	16.1	17.1	16.8	15.9	16.5	21.6	27.0	51.7	149.6
G. Other Provisions													
1. Restriction on insurance business exception to passive foreign investment company rules.......................................	tyba 12/31/17	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.5	1.1

Provision	Effective	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
2. Repeal of fair market value method of interest expense apportionment	tyba 12/31/17	[5]	0.1	0.1	0.1	[5]	[5]	[5]	[5]	[5]	[5]	0.3	0.6
Total of International Tax Reform		**68.9**	**42.6**	**26.0**	**28.0**	**22.9**	**22.5**	**36.7**	**48.7**	**29.1**	**-0.8**	**188.2**	**324.4**
NET TOTAL		**-135.7**	**-280.0**	**-258.8**	**-220.8**	**-178.3**	**-137.9**	**-120.1**	**-114.6**	**-40.6**	**32.9**	**-1,074.0**	**-1,456.0**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is generally assumed to be December 22, 2017.

Legend for "Effective" column:

apa = amounts paid after
apisasd = and placed in service after such date
apoaa = amounts paid or accrued after
apoia = amounts paid or incurred after
apoii = amounts paid or incurred in
apoio/a = amounts paid or incurred on or after
ar = advance refunding
bia = bonds issued after
cmi = contributions made in
da = distributions after
Da = dispositions after
dda = decedents dying after
DOE = date of enactment
doia = discharges of indebtedness after
dosaeia = divorce or separation agreements entered into after
eca = exchanges completed after
fc = for charitable
feoqb = for expansion of qualifying beneficiaries
gma = gifts made after
lai = losses accrued in
mba = months beginning after
paa = property acquired after
ppisa = property placed in service after
ptyba = partnership taxable years beginning after
sa = sales after
seada = sales exchanges and dispositions after
seado/a = sales, exchanges and dispositions on or after
spo/a = service provided on or after
sppoga = specified plants planted or grafted after
ta = transactions after
Ta = transfers after
teia = transactions entered into after
ti = transfers in
topia = transfers of partnership interests after
tyba = taxable years beginning after

[Footnotes for Table #17-2 128 R3 appear on the following pages]

Footnotes for Table #17-2 128 R3:

[1] The parameters for the beginning of the 24%, 32%, 35%, and 37% rate brackets, and the standard deduction amount use 2018 as the base year. Other indexed parameters are adjusted for inflation from their 2017 values using the chained CPI-U as the inflation measure to determine 2018 values.

[2] Estimate includes the following outlay effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets	---	1.0	1.1	1.2	1.2	1.2	1.2	1.2	1.3	---	4.4	9.3
Modify standard deduction	---	9.4	9.7	10.1	10.3	10.5	10.6	10.7	10.9	---	39.6	82.3
Repeal of deduction for personal exemptions	-10.8	-16.0	-16.4	-16.7	-17.0	-17.3	-17.5	-17.8	-5.4	---	-77.0	-134.9
Alternative inflation measure	---	-0.3	-0.6	-1.3	-1.6	-2.1	-2.5	-3.1	-3.6	-4.1	-3.9	-19.3
Modification of child tax credit	---	21.8	22.1	22.0	22.0	23.1	23.1	23.1	24.1	---	87.9	181.3
Require valid Social Security number of each child to claim refundable and non-refundable portions of child credit, non-child dependents and any child without a valid Social Security number still receives $500 non-refundable credit	---	-3.0	-2.9	-2.8	-2.7	-2.7	-2.7	-2.6	-2.6	-0.5	-11.4	-22.4
Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to $10,000 in State and local taxes), interest on mortgage debt in excess of $750K, interest on home equity debt, non-disaster casualty losses and certain miscellaneous expenses	---	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	---	-0.8	-1.7
Reduce ACA individual shared responsibility payment amount to zero	---	-5.8	-12.7	-28.2	-35.2	-38.4	-40.7	-43.0	-45.3	-48.0	-81.9	-297.3
Repeal of alternative minimum tax on corporations	2.2	2.3	1.7	1.9	1.9	---	---	---	---	---	10.2	10.2
Repeal of tax credit bonds	[26]	[26]	[26]	[26]	[26]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5

[3] Loss of less than $50 million.

[4] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect (SECA interaction)	-1.4	-1.9	-1.7	-1.5	-1.1	1.5	2.5	1.7	1.2	0.8	-7.7	[3]
On-budget effects	-0.3	-0.4	-0.4	-0.3	-0.2	0.3	0.5	0.4	0.2	0.2	-1.6	[3]
Off-budget effects	-1.1	-1.5	-1.4	-1.2	-0.9	1.2	2.0	1.3	0.9	0.6	-6.1	[3]

[5] Gain of less than $50 million.

[6] Estimate includes the following budget effects:

	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	0.6	0.7	0.2	---	2.7	4.8
On-budget effects	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.1	---	2.1	3.8
Off-budget effects	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	---	---	0.6	1.0

[7] Estimate includes policy that retains exclusion under section 217(g) (related to members of the Armed Forces).

[8] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
On-budget effects	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	-0.1	[1]	-0.3
Off-budget effects	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-0.1	[3]	-0.2

[9] Estimate provided by the Joint Committee on Taxation staff in collaboration with the Congressional Budget Office.

[Footnotes for Table #17-2 128 R3 continue on the following page]

Footnotes for Table #17-2 128 R3 continued:

[10] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	---	6.0	9.7	28.4	37.0	40.7	43.5	46.1	49.6	53.3	80.8	314.1
On-budget effects	---	5.9	9.0	26.5	34.8	38.3	40.8	43.3	46.7	50.5	76.1	295.6
Off-budget effects	---	0.1	0.8	1.9	2.3	2.4	2.7	2.9	2.9	2.8	4.9	18.7

[11] Effective with respect to: (1) levies made after the date of enactment; and (2) levies made on or before the date of enactment provided that the nine-month period has not expired as of the date of enactment.

[12] The expansion of the threshold allowing the use of the cash method, the creation of an exemption from the requirement to use inventories, and the expansion of the exception from the uniform capitalization rules are effective for taxable years beginning after December 31, 2017. The expansion of the exception from the requirement to use the percentage of completion method is effective for contracts entered into after December 31, 2017, in taxable years ending after such date. The threshold applicable to each provision is indexed for inflation for taxable years beginning after December 31, 2018.

[13] The percentage is phased down from 100 percent by 20 percent per calendar year beginning in 2023 (2024 for certain longer production period property and certain aircraft).

[14] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	1.6	2.2	2.2	2.3	2.3	2.4	2.4	2.5	2.8	2.8	10.6	23.5
On-budget effects	1.3	1.8	1.9	1.9	1.9	2.0	2.0	2.1	2.3	2.4	8.8	19.7
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

[15] Estimate includes the following budget effects:

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2018-22	2018-27
Total Revenue Effect	1.2	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	8.1	17.7
On-budget effects	1.0	1.3	1.4	1.4	1.4	1.5	1.5	1.5	1.6	1.6	6.5	14.2
Off-budget effects	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	1.6	3.5

[16] Generally effective for taxable years beginning after December 31, 2017. Effective for taxable years beginning after December 31, 2018 for income from a debt instrument having original issue discount.

[17] 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 or 60-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 or 60-month period ends.

[18] Transition rule for any remuneration under a written binding contract which was in effect on November 2, 2017, and which was not modified thereafter in any material respect.

[19] 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.

[20] Generally, taxable years beginning after December 31, 2016. The deduction for contributions to a Settlement Trust is effective for taxable years for which the Native Corporation's refund statute of limitations period has not expired, with a one-year waiver of the refund statute of limitations period in the event that the period expires before the end of the one-year period beginning on the date of enactment.

[21] Effective for contributions made after date of enactment, except that the provision does not apply to contributions pursuant to plans approved prior to date of enactment.

[22] Effective for distributions made (and for purposes of determining a taxpayer's foreign tax credit limitation under section 904, deductions in taxable years ending) after December 31, 2017.

[23] Effective for the last taxable year beginning before January 1, 2018, of a foreign corporation and with respect to U.S. shareholders for the taxable years in which or with which such taxable year of the foreign corporation ends.

[24] 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.

[25] Effective for the last taxable year beginning before January 1, 2018, of a foreign corporation and all subsequent years, and with respect to U.S. shareholders for the taxable years in which or with which such taxable year of the foreign corporation ends.

[26] Decrease in outlays of less than $50 million.

From the Committee on Ways and Means, for consideration of the House bill and the Senate amendment, and modifications committed to conference:

KEVIN BRADY,
DEVIN NUNES,
PETER J. ROSKAM,
DIANE BLACK,
KRISTI L. NOEM,

From the Committee on Energy and Commerce, for consideration of sec. 20003 of the Senate amendment, and modifications committed to conference:

FRED UPTON,
JOHN SHIMKUS,

From the Committee on Natural Resources, for consideration of secs. 20001 and 20002 of the Senate amendment, and modifications committed to conference:

ROB BISHOP,
DON YOUNG,
Managers on the Part of the House.

ORRIN G. HATCH,
MICHAEL B. ENZI,
LISA MURKOWSKI,
JOHN CORNYN,
JOHN THUNE,
ROB PORTMAN,
TIM SCOTT,
PATRICK J. TOOMEY,
Managers on the Part of the Senate.

COMMUNICATION FROM THE CLERK OF THE HOUSE

The SPEAKER pro tempore laid before the House the following communication from the Clerk of the House of Representatives:

OFFICE OF THE CLERK,
HOUSE OF REPRESENTATIVES,
Washington, DC, December 14, 2017.

Hon. PAUL D. RYAN,
The Speaker, House of Representatives, Washington, DC.

DEAR MR. SPEAKER: Pursuant to the permission granted in Clause 2(h) of Rule II of the Rules of the U.S. House of Representatives, the Clerk received the following message from the Secretary of the Senate on December 14, 2017, at 5:58 p.m.:

That the Senate passed S. 654.

With best wishes, I am,

Sincerely,

KAREN L. HAAS.

HOUSE BILLS AND JOINT RESOLUTIONS APPROVED BY THE PRESIDENT

The President notified the Clerk of the House that on the following dates he had approved and signed bills and joint resolutions of the following titles:

October 6, 2017:

H.R. 2519. An Act to require the Secretary of the Treasury to mint commemorative coins in recognition of the 100th anniversary of The American Legion.

October 18, 2017:

H.R. 1117. An Act to require the Administrator of the Federal Emergency Management Agency to submit a report regarding certain plans regarding assistance to applicants and grantees during the response to an emergency or disaster.

October 26, 2017:

H.R. 2266. An Act making additional supplemental appropriations for disaster relief requirements for the fiscal year ending September 30, 2018, and for other purposes.

November 1, 2017:

H.J. Res. 111. A joint resolution providing for congressional disapproval under chapter 8 of title 5, United States Code, of the rule submitted by Bureau of Consumer Financial Protection relating to ''Arbitration Agreements''.

November 2, 2017:

H.R. 1329. An Act to increase, effective as of December 1, 2017, the rates of compensa tion for veterans with service-connected disabilities and the rates of dependency and indemnity compensation for the survivors of certain disabled veterans, and for other purposes.

H.R. 1616. An Act to amend the Homeland Security Act of 2002 to authorize the National Computer Forensics Institute, and for other purposes.

H.R. 2989. An Act to establish the Frederick Douglass Bicentennial Commission.

November 17, 2017:

H.R. 304. An Act to amend the Controlled Substances Act with regard to the provision of emergency medical services.

H.R. 3031. An Act to amend title 5, United States Code, to provide for flexibility in making withdrawals from a Thrift Savings Plan account, and for other purposes.

November 21, 2017:

H.R. 194. An Act to ensure the effective processing of mail by Federal agencies, and for other purposes.

H.R. 1545. An Act to amend title 38, United States Code, to clarify the authority of the Secretary of Veterans Affairs to disclose certain patient information to State controlled substance monitoring programs, and for other purposes.

H.R. 1679. An Act to ensure that the Federal Emergency Management Agency's current efforts to modernize its grant management system includes applicant accessibility and transparency, and for other purposes.

H.R. 3243. An Act to amend title 40, United States Code, to eliminate the sunset of certain provisions relating to information technology, to amend the National Defense Authorization Act for Fiscal Year 2015 to extend the sunset relating to the Federal Data Center Consolidation Initiative, and for other purposes.

H.R. 3949. An Act to amend title 38, United States Code, to provide for the designation of State approving agencies for multi-State apprenticeship programs for purposes of the educational assistance programs of the Department of Veterans Affairs.

December 8, 2017:

H.J. Res 123. A joint resolution making further continuing appropriations for fiscal year 2018, and for other purposes.

December 12, 2017:

H.R. 2810. An Act to authorize appropriations for fiscal year 2018 for military activities of the Department of Defense, for military construction, and for defense activities of the Department of Energy, to prescribe military personnel strengths for such fiscal year, and for other purposes.

H.R. 4374. An Act to amend the Federal Food, Drug, and Cosmetic Act to authorize additional emergency uses for medical products to reduce deaths and severity of injuries caused by agents of war, and for other purposes.

SENATE BILLS APPROVED BY THE PRESIDENT

The President notified the Clerk of the House that on the following dates he had approved and signed bills of the Senate of the following titles:

October 6, 2017:

S. 327. An Act to direct the Securities and Exchange Commission to provide a safe harbor related to certain investment fund research reports, and for other purposes.

S. 810. An Act to facilitate construction of a bridge on certain property in Christian County, Missouri, and for other purposes.

S. 1141. An Act to ensure that the United States promotes the meaningful participation of women in mediation and negotiation processes seeking to prevent, mitigate, or resolve violent conflict.

October 18, 2017:

S. 178. An Act to prevent elder abuse and exploitation and improve the justice system's response to victims in elder abuse and exploitation cases.

S. 652. An Act to amend the Public Health Service Act to reauthorize a program for early detection, diagnosis, and treatment regarding deaf and hard-of-hearing newborns, infants, and young children.

October 26, 2017:

S. 585. An Act to provide greater whistleblower protections for Federal employees, increased awareness of Federal whistle-blower protections, and increased accountability and required discipline for Federal supervisors who retaliate against whistle-blowers, and for other purposes.

November 2, 2017:

S. 190. An Act to provide for consideration of the extension under the Energy Policy and Conservation Act of nonapplication of No-Load Mode energy efficiency standards to certain security or life safety alarms or surveillance systems, and for other purposes.

S. 504. An Act to permanently authorize the Asia-Pacific Economic Cooperation Business Travel Card Program.

S. 782. An Act to reauthorize the National Internet Crimes Against Children Task Force Program, and for other purposes.

S. 920. An Act to establish a National Clinical Care Commission.

S. 1617. An Act to designate the checkpoint of the United States Border Patrol located on United States Highway 77 North in Sarita, Texas, as the ''Javier Vega, Jr. Border Patrol Checkpoint''.

SENATE BILL REFERRED

A bill of the Senate of the following title was taken from the Speaker's table and, under the rule, referred as follows:

S. 654. An act to revise section 48 of title 18, United States Code, and for other purposes; to the Committee on the Judiciary.

ADJOURNMENT

Mr. BRADY of Texas. Mr. Speaker, I move that the House do now adjourn.

The motion was agreed to; accordingly (at 5 o'clock and 33 minutes p.m.), under its previous order, the House adjourned until Monday, December 18, 2017, at noon for morning-hour debate.

EXECUTIVE COMMUNICATIONS, ETC.

Under clause 2 of rule XIV, executive communications were taken from the Speaker's table and referred as follows:

3410. A letter from the Acting Director, Office of Surface Mining Reclamation and Enforcement, Department of the Interior, transmitting the Department's final rule — Oklahoma Regulatory Program [SATS No.: OK-037-FOR; Docket ID: OSM-2015-0006; S1D1S SS08011000 SX064A000 189S180110; S2D2S SS08011000 SX064A000 18XS501520] received December 13, 2017, pursuant to 5

U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Natural Resources.

3411. A letter from the Acting Director, Office of Surface Mining Reclamation and Enforcement, Department of the Interior, transmitting the Department's final rule — Wyoming Regulatory Program [SATS No.: WY-045-FOR; Docket ID.: OSM-2013-0002; S1D1S SS08011000 SX064A000 189S180110; S2D2S SS08011000 SX064A000 18XS501520] received December 13, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Natural Resources.

3412. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; Airbus Helicopters (Type Certificate Previously Held by Eurocopter France) [Docket No.: FAA-2015-4031; Product Identifier 2014-SW-072-AD; Amendment 39-19085; AD 2017-22-05] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3413. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; Bombardier, Inc., Airplanes [Docket No.: FAA-2017-0562; Product Identifier 2017-NM-027-AD; Amendment 39-19088; AD 2017-22-08] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3414. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; The Boeing Company Airplanes [Docket No.: FAA-2017-0772; Product Identifier 2017-NM-075-AD; Amendment 39-19099; AD 2017-23-05] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3415. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; The Boeing Company Airplanes [Docket No.: FAA-2017-0715; Product Identifier 2017-NM-073-AD; Amendment 39-19096; AD 2017-23-02] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3416. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; Bombardier, Inc., Airplanes [Docket No.: FAA-2017-0528; Product Identifier 2017-NM-028-AD; Amendment 39-19091; AD 2017-22-11] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3417. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; Airbus Airplanes [Docket No.: FAA-2017-0710; Product Identifier 2017-NM-019-AD; Amendment 39-19098; AD 2017-23-04] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3418. A letter from the Management and Program Analyst, FAA, Department of Transportation, transmitting the Department's final rule — Airworthiness Directives; Saab AB, Saab Aeronautics (Formerly Known as Saab AB, Saab Aerosystems) Airplanes [Docket No.: FAA-2017-0777; Product Identifier 2017-NM-050-AD; Amendment 39-19089; AD 2017-22-09] (RIN: 2120-AA64) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

3419. A letter from the Trial Attorney, Federal Railroad Administration, transmitting the Administration's final rule — System Safety Program [Docket No.: FRA-2011-0060, Notice No.: 7] (RIN: 2130-AC71) received December 14, 2017, pursuant to 5 U.S.C. 801(a)(1)(A); Public Law 104-121, Sec. 251; (110 Stat. 868); to the Committee on Transportation and Infrastructure.

REPORTS OF COMMITTEES ON PUBLIC BILLS AND RESOLUTIONS

Under clause 2 of rule XIII, reports of committees were delivered to the Clerk for printing and reference to the proper calendar, as follows:

Mr. BRADY of Texas: Committee of Conference. Conference report on H.R. 1. A bill to provide for reconciliation pursuant to title II of the concurrent resolution on the budget for fiscal year 2018 (Rept. 115–466). Ordered to be printed.

PUBLIC BILLS AND RESOLUTIONS

Under clause 2 of rule XII, public bills and resolutions of the following titles were introduced and severally referred, as follows:

By Mrs. COMSTOCK:

H.R. 4661. A bill to reauthorize the United States Fire Administration, the Assistance to Firefighters Grants program, the Fire Prevention and Safety Grants program, and the Staffing for Adequate Fire and Emergency Response grant program, and for other purposes; to the Committee on Science, Space, and Technology.

By Mr. LAWSON of Florida:

H.R. 4662. A bill to amend the Higher Education Act of 1965 to exclude the income and assets of dependent students in the calculation of the expected family contribution for such students; to the Committee on Education and the Workforce.

By Mr. SEAN PATRICK MALONEY of New York (for himself and Mr. GALLAGHER):

H.R. 4663. A bill to improve the ability of separating or retiring members of the Armed Forces to seek services provided by county veterans service officers; to the Committee on Armed Services.

By Mr. MEADOWS:

H.R. 4664. A bill to repeal the multi-State plan program; to the Committee on Energy and Commerce, and in addition to the Committee on Appropriations, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned.

By Ms. MOORE (for herself and Mr. COOK):

H.R. 4665. A bill to amend the Federal Credit Union Act to establish procedures for Federal credit unions to provide credit union services to underserved areas, and for other purposes; to the Committee on Financial Services.

By Mr. HIMES (for himself, Mr. ESPAILLAT, Mr. BEN RAY LUJÁN of New Mexico, Ms. MICHELLE LUJAN GRISHAM of New Mexico, Mr. QUIGLEY, Ms. NORTON, and Mr. SERRANO):

H. Res. 665. A resolution recognizing the crew of the San Antonio Rose, B-17F, who sacrificed their lives during World War II, and honoring their memory during the week of the 75th anniversary of that tragic event; to the Committee on Armed Services.

By Mr. RASKIN:

H. Res. 666. A resolution amending the Rules of the House of Representatives to observe a 60-second moment of silence in the House for those killed by gun violence in the United States on the next legislative day after any such individual dies; to the Committee on Rules.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 7 of rule XII of the Rules of the House of Representatives, the following statements are submitted regarding the specific powers granted to Congress in the Constitution to enact the accompanying bill or joint resolution.

By Mrs. COMSTOCK:

H.R. 4661.

Congress has the power to enact this legislation pursuant to the following:

Article I, Section 8, Clause 18:

The Congress shall have Power To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

By Mr. LAWSON of Florida:

H.R. 4662.

Congress has the power to enact this legislation pursuant to the following:

Article 1, Section 8: To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or any Department or Offifcer thereof.

By Mr. SEAN PATRICK MALONEY of New York:

H.R. 4663.

Congress has the power to enact this legislation pursuant to the following:

Article I, Section 8

By Mr. MEADOWS:

H.R. 4664.

Congress has the power to enact this legislation pursuant to the following:

Aritlce I, Section 8, Clause I states ''The Congress shall have Power to . . . provide for the . . . general Welfare of the United States . . . '' And, Article IV, Section 3, Clause 2 states ''The Congress shall have Power to dispose of and make all needful Rules and Regulations . . .'' And, Article I, Section 8, Clause 18 states ''The Congress shall have Power To . . . make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.''

By Ms. MOORE:

H.R. 4665.

Congress has the power to enact this legislation pursuant to the following:

The Commerce Clause describes an enumerated power listed in the United States Constitution (Article I, Section 8, Clause 3).

ADDITIONAL SPONSORS

Under clause 7 of rule XII, sponsors were added to public bills and resolutions, as follows:

H.R. 392: Mr. CURTIS.
H.R. 807: Mr. PERLMUTTER and Mr. FASO.
H.R. 912: Mr. MEEKS and Mr. WELCH.
H.R. 1159: Mr. ZELDIN.
H.R. 1318: Mr. DENHAM.
H.R. 1569: Mr. DESAULNIER and Ms. MICHELLE LUJAN GRISHAM of New Mexico.
H.R. 1691: Ms. SPEIER.
H.R. 2234: Mr. DESAULNIER.
H.R. 2687: Mrs. BUSTOS, Mr. DESAULNIER, and Mr. POLIQUIN.
H.R. 2809: Mr. SOTO.
H.R. 2881: Mr. DUFFY.
H.R. 3264: Ms. ROYBAL-ALLARD.
H.R. 3632: Mr. MEEKS and Mr. PANETTA.
H.R. 3730: Mr. EMMER, Mr. JOHNSON of Georgia, Mr. PAULSEN, Mr. RODNEY DAVIS of Illinois, Mr. SWALWELL of California, Mr. WALZ, and Mr. OLSON.
H.R. 3776: Mr. MARINO, Mr. CICILLINE, Ms. FRANKEL of Florida, Mr. WILSON of South Carolina, and Mrs. MURPHY of Florida.
H.R. 3881: Mr. DEFAZIO.
H.R. 4007: Ms. SHEA-PORTER, Ms. JUDY CHU of California, Mr. CLAY, Mr. CONNOLLY, Mr. COURTNEY, Mr. ENGEL, Ms. HANABUSA, Ms. JACKSON LEE, Mr. KEATING, Mr. KRISHNAMOORTHI, Mr. TED LIEU of California, Mr. LIPINSKI, Ms. MCCOLLUM, Ms. MENG, Mr. NORCROSS, Mr. PALLONE, Mr. RUPPERSBERGER, Ms. SCHAKOWSKY, Mrs. MURPHY of Florida, Ms. TSONGAS, Ms. VELÁZQUEZ, Mr. YARMUTH, and Ms. SEWELL of Alabama.
H.R. 4022: Mr. CURBELO of Florida, Ms. EDDIE BERNICE JOHNSON of Texas, Mr. BLUMENAUER, and Mr. MCHENRY.
H.R. 4217: Mr. BISHOP of Michigan.
H.R. 4271: Ms. JAYAPAL, Mr. SERRANO, Mr. RASKIN, Mr. BLUMENAUER, Ms. ESHOO, and Mr. SWALWELL of California.
H.R. 4293: Mr. DAVID SCOTT of Georgia.
H.R. 4318: Mr. RATCLIFFE, Mr. GAETZ, Mr. MCCLINTOCK, Ms. MCSALLY, and Mr. BANKS of Indiana.
H.R. 4375: Mrs. BUSTOS.
H.R. 4396: Mr. KILDEE, Mr. HOYER, and Mr. SCHRADER.
H.R. 4513: Mr. SOTO.
H.R. 4541: Mrs. DAVIS of California, Mr. CRIST, Mr. TAKANO, Mr. AL GREEN of Texas, Mr. BRENDAN F. BOYLE of Pennsylvania, Ms. WASSERMAN SCHULTZ, Mr. BERA, Mr. HASTINGS, Mr. SCHRADER, Ms. ROSEN, Mr. FOSTER, Ms. MENG, Mr. KEATING, Ms. MOORE, Mr. DELANEY, and Mrs. LAWRENCE.
H.R. 4547: Mr. BACON and Mr. SMITH of Washington.
H.R. 4585: Mr. LEVIN, Mr. COHEN, Mrs. NAPOLITANO, Mr. SERRANO, Mrs. DAVIS of California, and Mr. SMITH of Washington.
H. Res. 199: Mr. GAETZ.
H. Res. 318: Mr. KINZINGER.
H. Res. 466: Mr. MCHENRY and Ms. SHEA-PORTER.

DISCHARGE PETITIONS— ADDITIONS AND WITHDRAWALS

The following Member added his name to the following discharge petition:

Petition 3 by Mr. GARRETT on House Resolution 458: Mr. Mooney of West Virginia.

ENDNOTES

This table belongs to Footnote **520**

Recovery method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
200-percent declining balance	288.71	204.08	145.77	104.12	86.77	86.77	86.77	1,000.00
150-percent declining balance	214.29	168.37	132.29	121.26	121.26	121.26	121.26	1,000.00
Straight-line	142.86	142.86	142.86	142.86	142.86	142.86	142.86	1,000.00

This table belongs to Footnote **540**

Recovery method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
200-percent declining balance	285.71	204.08	145.77	104.12	86.77	86.77	86.77	1,000.00
150-percent declining balance	214.29	2168.37	132.29	121.26	121.26	121.26	121.26	1,000.00
Straight -line	142.86	142.86	142.86	142.86	142.86	142.86	142.86	1,000.00

This table belongs to Footnote **573**

Recovery method	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Total
200-percent delining balance	285.71	204.08	145.77	104.12	86.77	86.77	86.77	1,000.00
150-percent declining balance	214.29	168.37	132.29	121.26	121.26	121.26	121.26	1,000.00
Straight-line	142.86	142.86	142.86	142.86	142.86	142.86	142.86	1,000.00