What's in the Tax Agreement for Businesses and Non-Profits?

By Sarah Babbage | December 17, 2017 8:38PM ET

The corporate income tax would be reduced to a flat rate of 21 percent under the conference report on H.R. 1.

The legislation represents a deal between House and Senate Republicans on their respective tax overhaul packages.

The agreement on the‘ ‘Tax Cuts and Jobs Act” would replace the graduated corporate income tax with a top 35 percent rate. It would end the worldwide tax on corporate income and instead adopt a new system of taxing multinational corporations.

To partially offset the cost of lower rates, the measure would modify or eliminate a number of credits and deductions.

The corporate tax changes in the agreement would be permanent, while many of the major individual provisions, including changes for passthrough businesses, would sunset after 2025.

Click here for the BGOV Bill Summary: Individual Provisions in H.R. 1 Agreement.

The legislation would require two oil lease sales of at least 400,000 acres each in the Arctic National Wildlife Refuge in Alaska and direct the Energy Department to sell as much as 7 million barrels of crude oil from the Strategic Petroleum Reserve. It would increase the limit on offshore revenue shared with Gulf States to $650 million, from $500 million, in fiscal 2020 and 2021.

The House passed its version of H.R. 1 by a vote of 227-205 on Nov. 16. The Senate passed an amended version of H.R. 1 by a vote of 51-49 on Dec. 2. All Republican negotiators, but no Democrats, signed the conference report, which was filed Dec. 15.

The House is scheduled to consider the conference report on Dec. 19, when Senate leaders have also said they’ll consider it. Because the measure is being advanced using the budget reconciliation process, only a simple majority is required in the House and Senate. If the conference report is adopted by both chambers, the measure would be sent to the president for his signature.

REVENUE EFFECTS

The conference agreement would reduce revenue by $1.46 trillion in fiscal years 2018 through 2027 on a static basis, according to a joint analysis from the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT). It would reduce revenue by $1.65 trillion over a decade, which would be partially offset by a $194 billion reduction in outlays.

The fiscal 2018 budget resolution (H. Con. Res. 71) allowed the measure's tax provisions to add as much as $1.5 trillion to the deficit over a decade based on static estimates.

The changes to the taxation of domestic corporate income would reduce revenue by $653.8 billion, while the measure's international business tax changes would increase revenue by $324.4 billion.

The oil provisions would reduce mandatory spending by $1.1 billion over a decade, according to CBO and JCT.

JCT haven't issued a dynamic score of the agreement, which would account for macroeconomic effects. JCT estimated the Senate Finance Committee-approved legislation (S. 1) would have reduced revenue by $1 trillion after accounting for economic effects (see BGOV Closer Look), and that H.R. 1 as passed by the House would also reduce revenue by $1 trillion on a dynamic basis.

JCT's estimates of the measure's provisions included in the conference committee's joint explanatory statement were marked as "very preliminary."

CORPORATE RATES AND DEDUCTIONS

The graduated income tax with a top rate of 35 percent would be replaced by a flat 21 percent corporate income tax rate beginning in the 2018 tax year. The change would reduce revenue by $1.35 trillion in fiscal 2018 through 2027, according to JCT.

The conference agreement would specify the accounting method taxpayers should use to normalize excess tax reserves that result from the rate reduction.

The alternative minimum tax (AMT) would be repealed, as proposed by the House bill. Corporations could continue to use their AMT credits to offset their regular tax liability. Credits would be partially refundable in tax years 2018 through 2021. The provision would reduce revenue by $40.3 billion over a decade.

Interest Deduction

The net interest expense deduction would be limited to 30 percent of a business's adjusted taxable income. In 2018 through 2021, adjusted taxable income would be considered earnings before interest, taxes, depreciation, and amortization ("EBITDA"). In subsequent years, the deduction would reflect earnings before interest and taxes ("EBIT").

Interest amounts greater than 30 percent could be carried forward into future tax years.

Businesses with average gross receipts of $25 million or less, public utilities, and certain real estate businesses could continue to deduct all of their net interest expense under existing terms and limits. Farming businesses could choose to deduct their interest instead of using the measure's full expensing provision. Interest from "floor plan financing," used by car dealerships and other companies with high-interest inventory, could still be deducted.

The deduction for passthrough entities, which can include sole proprietorships, partnerships, limited liability companies, and S corporations, would be at the partnership level, so multiple partners in a business couldn't double-count the partnership's interest expense.

Limiting the interest deduction would increase revenue by $253.4 billion in fiscal 2018 through 2027, according to JCT.

Net Operating Loss Deduction

The conference agreement would modify businesses' ability to carry their operating losses to other tax years.

The net operating loss deduction carryover would be limited to 80 percent of a taxpayer's eligible income, computed without consideration of the deduction itself.

The ability to carry back a loss to a previous year would be repealed, but losses could be carried forward indefinitely. The measure would make exceptions for farms -- which could carry losses back two years -- and property and casualty insurance companies -- which could carry losses back two years and forward 20 years, as under current law.

The net operating loss changes would increase revenue by $201.1 billion in fiscal years 2018 through 2027, according to JCT.

Intellectual Property

Earnings from self-created property would be taxed as ordinary income.

Under current law, some earnings from self-created property -- such as an invention or secret formula -- are treated as capital gains, while earnings from others -- such as copyrights and letters -- are treated as ordinary income.

The measure would tax all such forms of self-created property equally. It would retain an exception for music composers and copyright holders, who can elect to treat earnings from the sale of their compositions or copyrights as capital gains under current law.

The provision would increase revenue by $0.5 billion over fiscal years 2018 through 2027.

Other Business Deductions

DOMESTIC PRODUCTION: The measure would eliminate the deduction for domestic production, through which certain companies can deduct as much as 9 percent of their production income or taxable income.

The deduction, which is limited to 50 percent of the wages paid by the business, benefits a variety of industries, including manufacturing, energy, film, and construction.

The repeal would be effective in 2018 for noncorporate businesses and certain farms, and in 2019 for C corporations.

The repeal would increase revenue by $98 billion through fiscal 2027.

FRINGE BENEFITS: The deduction for business-related entertainment expenses would be eliminated. Meals provided to employees would continue to be deductible until 2025. When provided by a tax-exempt entity, such fringe benefits would be considered unrelated business income and therefore taxable.

The provisions would increase revenue by $23.5 billion over a decade.

The deduction for parking and transit benefits provided to employees would also be eliminated, which would increase revenue by $17.7 billion over a decade.

EXECUTIVE COMPENSATION: Commissions and performance-based pay, including stock options, would be included in compensation subject to a $1 million corporate employer deduction cap. Retirement plan contributions would continue to be excluded.

The provision would apply to the principal executive officer, financial officer, and three other highest-paid employees. Once an employee qualified, they would remain a covered employee for all future years.

The provision wouldn't apply to compensation plans established under a written binding contract as of Nov. 2, 2017, even if the employee had the right to participate in the plan but hadn't started participating. It would increase revenue by $9.2 billion over a decade.

FDIC: Under current law, financial institutions insured by the Federal Deposit Insurance Corporation can deduct the fees they pay to the Deposit Insurance Fund.

The conference agreement would limit the deduction for large financial institutions. Institutions with total consolidated assets of $50 billion or more couldn't use the deduction, while those with assets of $10 billion or less could use the full deduction. Companies with assets between those thresholds could access a partial deduction.

The provision would increase revenue by $14.8 billion over a decade.

LOCAL LOBBYING: The measure would end businesses' ability to deduct their expenses for lobbying local governments, effective for amounts paid as of the date of enactment. The change would increase revenue by $0.8 billion over fiscal years 2018 through 2027.

PENALTIES AND FINES: The legislation would modify which penalties and fines paid to a government aren't deductible, which would increase revenue by $0.1 billion over a decade.

SEXUAL HARASSMENT: Settlements, payouts, and attorney fees related to sexual harassment or abuse wouldn't be deductible if payments were subject to a nondisclosure agreement. Such payments are currently deductible as ordinary business expenses.

The provision would be effective for amounts paid or incurred after the measure's enactment and would increase revenue by less than $50 million through fiscal 2027.

EMPLOYEE ACHIEVEMENT AWARDS: The conference agreement would bar employers from deducting certain types of compensation -- including cash, gift cards, vacations, meals, lodging, theater or sports tickets, stocks, or bonds -- as an employee achievement award. According to the joint explanatory statement, the provision would clarify current law guidance.

The provision would increase revenue by less than $50 million over a decade.

Other Exclusions and Deferrals

LIKE-KIND EXCHANGE: The measure would limit taxpayers' ability to defer their gain from a like-kind exchange, in which they pay no immediate tax on equipment or real estate trades. Only a gain on real estate transfers could be deferred after 2017. The provision would increase revenue by $31 billion over fiscal years 2018 through 2027.

CONTRIBUTIONS TO CAPITAL: The measure would change the definition of contributions to a corporation's capital so they wouldn't be excluded from taxable income unless the contribution was made by a shareholder, potential customer, or governmental entity. The provision, which would be effective upon enactment, would increase revenue by $6.5 billion over a decade.

SECURITIES GAINS: Under current law, individuals or corporations can use the proceeds from the sale of a publicly traded security to purchase stock or interest in a specialized small business investment corporation without paying capital gains tax, subject to an annual limit.

Specialized small business investment corporations are venture capital firms licensed and regulated by the Small Business Administration that invest in certain small businesses. The program was repealed in 1996, although some corporations were grandfathered, according to a House Ways and Means Committee report on H.R. 1.

The measure would end rollovers for sales after the 2017 tax year, increasing revenue by $1.7 billion through fiscal 2027.

Paid Leave Credit

For employers that pay employees 50 percent of their wages while they are on family and medical leave, the measure would provide a credit for 12.5 percent of wages paid. The credit would be increased by 0.25 percentage point, to as much as 25 percent, for each percentage point that wages paid exceed 50 percent of regular earnings. The credit would be available for as many as 12 weeks of leave.

Employers would be eligible for the credit if they offered all full-time employees at least two weeks of annual family and medical leave, paid at a rate of at least 50 percent of their normal wage. Leave paid or required by a state or local government wouldn't be taken into account in determining the amount of paid leave provided by an employer. Sick leave and vacation and personal days wouldn't qualify as family and medical leave.

Employees would have to work for the employer for at least a year to qualify for the program.

The provision would be available for wages paid during the 2018 and 2019 tax years, and would reduce revenue by $4.3 billion through fiscal 2027.

Other Business Credits

ORPHAN DRUGS: A credit for developing treatments for rare diseases would be reduced to 25 percent of expenses from 50 percent. The provision would increase revenue by $32.5 billion in fiscal 2018 through 2027, according to JCT.

BUILDING REHAB: The 10 percent credit for rehabilitation of structures that aren't historic would be eliminated. The 20 percent credit for historic structures would be retained but spread over five years.

Expenses for the rehabilitation of nonhistoric buildings owned by a taxpayer as of Jan. 1, 2018, could qualify for the credit if their rehabilitation began within 180 days of enactment.

The provision would increase revenue by $3.1 billion over a decade.

Accounting Provisions

The conference agreement would modify several corporate accounting methods for smaller businesses.

It would allow corporations and partnerships with corporate partners with average gross receipts of as much as $25 million (indexed for inflation) to use cash accounting, under which a business recognizes income and deducts expenses when cash is exchanged instead of having to accrue income and expenses. Cash accounting is already available to all sizes of sole proprietorships, partnerships without a corporate partner, and S corporations.

The measure would also allow farm corporations and partnerships with gross receipts of as much as $25 million to use cash accounting.

Eligible businesses could use cash accounting even if they had inventories. Under current law, businesses with inventory must use the accrual method of accounting for tax purposes.

Businesses with average gross receipts of $25 million or less -- instead of $10 million or less under current law -- would be exempt from uniform capitalization (UNICAP) rules. UNICAP rules require businesses to either include certain direct and indirect costs associated with property they manufacture in their inventory or capitalize those costs into the basis of that property.

The conference agreement would also modify the accounting method that businesses with average gross receipts of $25 million or less use for long-term contracts.

The accounting changes would reduce revenue by $30.5 billion in fiscal years 2018 through 2027.

Taxpayers would also be required to recognize income, aside from long-term contract income, when it is recorded on an audited financial statement, which would increase revenue by $4.5 billion over a decade.

Conversion from S to C Corporation

The conference agreement would specify how an S corporation's distributions should be taxed when it converts to a C corporation. Any resulting increase in tax could be paid over a six-year period.

The provision would apply to entities that convert in the two years after the legislation's enactment.

The provision would reduce revenue by $6.1 billion over a decade, according to JCT.

Small Business Trusts

Foreign individuals could be beneficiaries of electing small business trusts. Such trusts can have multiple beneficiaries, including individuals, estates, and charitable organizations.

Small business trusts' charitable contributions would follow the rules -- including limits and carryforwards -- applicable to individuals.

The provisions would reduce revenue by $0.3 billion over a decade.

Aircraft Excise Tax

The measure would clarify that private aircraft owners' payments for aircraft management services, such as maintenance and flight support, are exempt from a 7.5 percent excise tax.

According to Bloomberg's Anders Levin, some private-jet owners let management companies charter their planes to other customers and the Internal Revenue Service (IRS) has recently scrutinized whether those planes should qualify as commercially owned. If so, the owner's personal trips would be subject to excise taxes.

The provision would reduce revenue by less than $50 million through fiscal 2027.

Opportunity Zones

The measure would allow capital gains income to be temporarily deferred if invested in a low-income "qualified opportunity zone" fund. Gains from the sale or exchange of an investment in a qualified opportunity fund would be permanently excluded from income.

Opportunity zones would be nominated by a state governor or Washington, D.C.'s mayor and approved by the Treasury Department. Low-income census tracts in U.S. possessions would be deemed to be opportunity zones upon enactment.

The deferral wouldn't be available after 2026, and the gain from sales after 2026 couldn't be excluded from income.

The provision would reduce revenue by $1.6 billion over a decade.

COST RECOVERY

The conference agreement would allow full and immediate expensing of capital investments placed in service after Sept. 27, 2017, and before Jan. 1, 2023, in most cases. The provision would apply before Jan. 1, 2024, for certain property with a 10-year recovery period, transportation property, and certain aircraft.

After 2023, "bonus depreciation" would phase out by 20 percent per year through 2026 (or through 2027 for property that qualified for an extra year of full expensing).

The measure would expand the types of property eligible for bonus depreciation to include used property when first acquired by the taxpayer.

Film, television, and theater property would be eligible for bonus depreciation if the initial broadcast, release date, or performance date was after Sept. 27, 2017.

Property wouldn't qualify for bonus depreciation if it was acquired by a utility, or using floor plan financing that was covered under the interest deduction.

The bonus depreciation provisions would reduce revenue by $86.3 billion from fiscal 2018 through 2027, according to JCT.

Section 179

The conference agreement would expand “Section 179” expensing, which allows businesses to immediately expense some of the costs of qualifying property such as off-the-shelf computer software and some real property. Current law specifies that as much as $500,000 can be expensed unless more than $2 million in property is bought, in which case there’s a dollar-for-dollar reduction in the deductible amount. The thresholds are indexed for inflation.

Under the measure, as much as $1 million could be expensed under Section 179, while the phaseout threshold would be increased to $2.5 million. Both amounts would be indexed to inflation.

Eligibility for Section 179 expensing would be expanded to include furniture, as well as nonresidential roofs, heating and air conditioning systems, and fire and alarm systems.

The Section 179 provisions would reduce revenue by $25.9 billion through fiscal 2027.

Other Depreciation and Amortization Provisions

RESEARCH: Certain research and experimental expenditures would be amortized over five years if conducted in the U.S. and 15 years if conducted abroad. Such expenses can be deducted immediately under current law.

The rule would apply to expenses beginning in the 2022 tax year. It wouldn’t apply to expenses related to land acquisition or natural resource exploration.

The provision would increase revenue by $119.7 billion through fiscal 2027.

LUXURY VEHICLES: The depreciation limit for luxury vehicles would be limited to an aggregate maximum of $41,360 in the first four years of service, from $13,185 under current law.

FARMS: An expired tax break that allowed farmers to depreciate most machinery over five years instead of seven would be restored. The measure would also repeal a rule that requires certain farm business property to be depreciated over a longer period of time than property used in other industries. The provision would reduce revenue by $1.1 billion over a decade.

Farms that elected not to use the interest deduction would have to use an alternative depreciation system to depreciate property with a recovery period of 10 years or more.

REAL PROPERTY: The measure would allow a 15-year recovery period for property improvements and a 20-year alternative depreciation system for such property under the modified accelerated cost recovery system (MACRS). It would reduce the alternative depreciation system recovery period for residential rental property to 30 years from 40 years. The provision would reduce revenue by $4.9 billion over a decade.

CITRUS: Investors who contribute to replanting citrus tress lost due to casualty, such as a storm, could deduct their costs. To access the deduction, the farm owner would have to retain at least 50 percent ownership of the plants. The measure would also offer the deduction for replanting costs to an investor who bought a farm with lost or diseased citrus plants.

The provision, which would be effective for costs incurred for 10 years after the legislation's enactment, would reduce revenue by less than $50 million over a decade.

PASSTHROUGHS

During tax years 2018 through 2025, the measure would modify the tax treatment of certain businesses organized as passthroughs, which can include sole proprietorships, partnerships, limited liability companies, and S corporations. They would continue to pay tax through the individual income system, but would be allowed a deduction for 20 percent of their domestic qualified business income.

The deduction would be limited to either 50 percent of the "W-2 wages" they paid or 25 percent of W-2 wages plus 2.5 percent of the cost of their tangible, depreciable property, which could benefit real estate companies, according to Bloomberg's Lynnley Browning and Ben Bain. The IRS would have to set guidelines for valuation and acquisition timing of property.

The wage limit wouldn't apply to taxpayers with income of $157,500 or less for individuals, or $315,000 or less for joint filers, indexed for inflation. The limit would phase in for taxpayers with incomes greater than those thresholds.

For partnerships and S corporations, the deduction would apply at the partner or shareholder level, based on their allocable share of W-2 wages.

The deduction would be limited for certain professional services businesses, including those in health, law, and accounting. It would only be fully available for service businesses with income of $157,500 or less for individuals or $315,000 or less for joint filers (indexed to inflation), and would phase out for incomes greater than those thresholds. Engineering, architecture, and investment management businesses wouldn't be considered service businesses.

Dividends from cooperatives and real estate investment trusts (REITs) and income from publicly traded partnerships would be deductible.

Agricultural and horticultural cooperatives, as well as trusts, could qualify for the deduction for part of their income.

The thresholds in the conference agreement are lower than those of $250,000 for individuals and $500,000 for joint filers in the Senate-passed measure. The joint explanatory statement said the reduction would “deter high-income taxpayers from attempting to convert wages or other compensation for personal services to income eligible for the 20-percent deduction.”

The House-passed measure would have established a new 25 percent tax rate for passthrough entities instead of a deduction.

The provision would reduce revenue by $414.5 billion from fiscal 2018 through 2027, according to JCT.

Losses

Losses that exceed a passthrough’s gross income or investment gains plus $250,000 for individual filers and $500,000 for joint filers could be carried forward as a net operating loss.

For partnerships and S corporations, the provision would apply at the partner or shareholder level, based on their share of income, gain, deduction, or loss.

The provision, which would apply during tax years 2018 through 2025, would increase revenue by $149.7 billion over a decade.

Partnerships

The measure would change the method for determining whether the gain or loss from the sale of a partnership interest that is considered effectively connected to business in the U.S. When a foreign partner sells their partnership interest, the portion of their gain attributable to U.S. trade or business assets would be taxable in the U.S. The provision may override the policy implications of a previous U.S. Tax Court decision, according to Bloomberg Tax’s Allyson Versprille.

The IRS would have to issue regulations to implement the measure. Additionally, the IRS could issue guidance to allow a broker to withhold 10 percent of the taxable portion of sales.

The provision would increase revenue by $3.8 billion through fiscal 2027.

The measure would expand the definition of a “substantial built-in loss,” which exceeds the fair market value of the partnership property by more than $250,000 immediately after partnership interest is transferred. Under the measure, a substantial built-in loss would also exist if the transferee would be allocated a net loss greater than $250,000 if all of the partnership’s assets were sold at fair market value immediately after the transfer. The provision would increase revenue by $0.5 billion over a decade.

The way charitable contributions and foreign taxes can be applied against partners' losses also would be modified. The provision would increase revenue by $1.2 billion through fiscal 2027.

The measure would modify rules for terminating a partnership. Under current law, a partnership is considered terminated for tax purposes when at least half of the total interests in its capital and profits are sold or exchanged within a 12-month period. Such a "technical termination" is considered the end of the partnership's taxable year, potentially resulting in a short tax year. If the partnership continues, it is treated as newly formed and has to make new elections, such as its accounting and depreciation methods.

The conference agreement would end the technical termination rule and retain partnerships' elections after 50 percent of its capital is sold or exchanged.

The provision would increase revenue by $1.6 billion from fiscal 2018 through 2027, according to JCT.

FOREIGN INCOME

The conference agreement would end the current tax on all income received by U.S. corporations regardless of whether it's earned in the U.S. or abroad. It would transition to a participation exemption system, with measures to prevent base erosion, and would impose a repatriation tax on earnings currently held offshore.

Under the new system, the foreign-source portion of dividends paid by a foreign subsidiary to its U.S. parent company would be tax-exempt, provided the parent owned at least 10 percent of the subsidiary's voting stock.

The measure would repeal a credit for deemed foreign income taxes paid on dividends received by a U.S. corporation that owns at least 10 percent of the voting stock in a foreign corporation.

The provision would reduce revenue by $223.6 billion from fiscal 2018 through 2027, according to JCT.

The measure would also establish a new tax treatment for sales or transfers of stock between U.S. and foreign corporations. If a U.S. parent corporation sold or exchanged stock in a foreign corporation that it had held for a year or more, it would reduce the basis of its stock in the subsidiary by the amount of tax-exempt dividends it had received for the purpose of determining a loss. If it transferred "substantially all" of the assets of a foreign branch to a foreign subsidiary, the transferred loss would be included in the U.S. corporation's gross income.

The provision would increase revenue by $11.8 billion over a decade.

Repatriation

The conference agreement would impose a one-time deemed repatriation tax on U.S. corporations' offshore earnings accumulated from 1987 through 2017. The rate for cash and other liquid assets would be 15.5 percent, while it would be 8 percent for other earnings. The liability could be paid in eight installments, which would be backweighted to the last three years.

Taxable earnings would be based on the amount of income accumulated after 1986 and as of either Nov. 2, 2017, or Dec. 31, 2017, whichever is greater.

Multinational corporations in which a U.S. company has at least 10 percent voting interest would have to pay the tax.

If a U.S. entity had ownership in both a foreign corporation with deferred earnings and one with a deficit, it could apply part of the deficit against its taxable income.

S corporations could continue to defer their tax liability until they changed their status, sold "substantially all" of their assets, ceased to conduct business, or a shareholder transferred their stock.

Accumulated earnings wouldn't be included in REITs for the purpose of the gross income test used to establish REIT status.

If a U.S entity expatriated in the 10 years after the bill's enactment, a 35 percent tax would be imposed on its deferred income.

The IRS would be directed to prescribe rules to prevent corporations from avoiding the tax by changing their entity classification, accounting method, or taxable year, or by shifting funds within the corporate group. The agency said providing guidance on the repatriation tax will be its first priority after the legislation is enacted.

The repatriation tax would increase revenue by $338.8 billion over a decade.

Passive and Mobile Income

The conference agreement would adopt a system for taxing "global intangible low-taxed income," which could include payments from certain foreign insurance, passive investment, and other businesses. The tax treatment would be similar to that used for "Subpart F" income, which is income from controlled foreign corporations that can't be deferred.

Global intangible low-taxed income would be defined as the excess of the U.S. shareholder's aggregate net income over a routine return of 10 percent on its share of its subsidiary's depreciable, tangible property. It would be subject to a 10 percent tax. Income that is effectively connected to business in the U.S., Subpart F income, foreign oil and gas income, and certain related party payments wouldn't be included.

C corporations, other than regulated investment companies and REITs, could apply an 80 percent deemed credit for foreign taxes paid.

Income from the sale of property that was transferred from a U.S. corporation to a foreign affiliate would be treated as global intangible low-taxed income if the foreign affiliate ultimately sells it.

The provision would increase revenue by $112.4 billion over a decade.

C corporations could claim a 37.5 percent deduction for foreign-derived intangible income (reduced to 21.875 percent in 2026) and a 50 percent deduction for global intangible low-taxed income (reduced to 37.5 percent in 2026).
The provision would reduce revenue by $63.8 billion over a decade.

The deductions in the measure, combined with the 21 percent corporate tax rate, would set the effective tax on foreign-derived intangible income at 13.125 percent and the effective tax on global intangible low-taxed income at 10.5 percent in 2018 through 2025, according to the conference report. The effective rates would be 16.406 percent and 13.125 percent, respectively, after 2025. The credit for foreign taxes paid could potentially reduce the effective U.S. tax on global intangible low-taxed income to zero.

Base Erosion Measures

The measure includes several additional provisions to preserve the U.S. corporate tax base and discourage tax avoidance as part of the switch away from the worldwide income tax system.

NEW TAX: The measure would establish a new base erosion and anti-abuse tax for all U.S. corporate taxpayers that have annual gross receipts greater than $500 million and make deductible payments to foreign related parties. It would apply if 10 percent of a company’s modified taxable income (after accounting for deductible payments to foreign related parties) exceeds its regular tax liability in that year. The 10 percent rate would be reduced to 5 percent in 2018, and would increase to 12.5 percent after 2025.

The cost of goods sold, amounts paid or incurred for certain services, and derivative payments wouldn’t be considered foreign related party payments.

The tax wouldn’t be imposed on U.S. corporations with foreign related party payments of less than 4 percent of their total expenses. It also wouldn’t apply to regulated investment companies, REITs, or S corporations.

The provision is designed to limit the ability of foreign-owned companies to use “earnings stripping” to reduce their U.S. tax liability by making deductible payments to a foreign parent company. It would increase revenue by $149.6 billion through fiscal 2027.

INTANGIBLE PROPERTY: The measure would clarify several definitional and methodological issues related to intangible property transfers, which would increase revenue by $1.3 billion through fiscal 2027.

FOREIGN DIVIDENDS: After the bill's enactment, shareholders that receive dividends from inverted corporations -- entities that move their residency from the U.S. for tax purposes -- couldn't access the lower rates on qualified dividends available for dividends from domestic corporations and qualified foreign corporations. The provision would increase revenue by $0.1 billion over a decade.

STOCK COMPENSATION: Stock compensation in inverted corporations would be subject to a 20 percent excise tax, instead of 15 percent under current law. The provision, which would be effective for stock in corporations that expatriate after the legislation's enactment, would increase revenue by $0.1 billion in fiscal 2018 through 2027.

DEDUCTIBLE TRANSACTIONS: A deduction for transactions between related corporations would be disallowed when the income received by a foreign corporation wouldn't be included in its gross income or would be deductible in its home country.

Foreign Tax Credits

Taxpayers with undeducted domestic losses from before 2018 could recharacterize more of their loss as foreign income than would otherwise be allowed. Recharacterizing a loss as foreign income allows a taxpayer to access the foreign tax credit. The election could be used in tax years 2018 through 2027.

The provision would reduce revenue by $2.3 billion over a decade.

Foreign branch income would have to be classified as either passive or general for purposes of the foreign tax credit, which has separate limits for the two categories.

Inventory

The measure would modify where income from inventory that is only partly produced in the U.S. is considered to have originated for tax purposes. For instance, income derived from inventory sold in the U.S., but produced entirely in another country, would be sourced to that country. The provision would increase revenue by $0.5 billion from fiscal years 2018 through 2027, according to JCT.

Interest Expense

Proposals to limit the ability of U.S. companies in a worldwide group to deduct their interest expense from the House and Senate weren't adopted in the final agreement.

The measure would end the ability of members of a U.S.-affiliated group to allocate interest expense on the basis of fair market value of assets if a taxpayer elected to discount their unpaid losses based on their historical payment pattern. They would have to allocate interest expense based on the adjusted tax basis of assets instead.

The provision would reduce revenue by $0.6 billion from fiscal years 2018 through 2027.

Subpart F Income

OIL: The conference agreement would repeal a provision in the tax code that requires a U.S. parent company to pay U.S. tax on certain oil-related income of its foreign subsidiary, even if the income isn't distributed to the U.S. parent. The provision would reduce revenue by $4 billion over a decade.

STOCK OWNERSHIP: The legislation would modify the stock attribution rules for determining whether income from a foreign corporation is subject to Subpart F.

It would also expand the definition of a U.S. shareholder to include any U.S. person who owns 10 percent or more of the total value of shares of all classes of stock in a foreign corporation, instead of 10 percent or more of the combined voting power, as under current law, which would increase revenue by $1.3 billion over a decade.

The measure would repeal a provision that subjects a U.S. parent company's income from a controlled foreign corporation to tax only if it owned stock in the subsidiary for at least 30 consecutive days in a year. The provision would increase revenue by $0.6 billion over fiscal years 2018 through 2027, according to JCT.

SHIPPING: The measure would repeal a provision of the tax code requiring U.S. shareholders to pay tax on income from foreign shipping companies if they didn't reinvest the funds in the company. The provision would reduce revenue by less than $50 million through fiscal 2027.

INSURANCE

The conference agreement includes several changes to the taxation of life, property and casualty insurance companies. A House proposal to impose an additional 8 percent tax on life insurance company taxable income was dropped.

Life Insurance

The measure would modify the ability of life insurance companies to move losses to other tax years.

Under the proposal, they could carry net operating losses back as many as two years or forward as many as 20 years, as other types of businesses are allowed. Losses can currently be carried back three years or forward 15 years.

The measure would repeal a deduction that allows small life insurance companies to deduct 60 percent of their first $3 million in income from life insurance policies. The provision would increase revenue by $0.2 billion through fiscal 2027, according to JCT.

Life insurance companies would be required to pay tax on any income or loss that results from a change in how they calculate their reserves over four years instead of 10. The provision would increase revenue by $1.2 billion over a decade.

The measure would modify the way insurance companies calculate increases in certain reserve funds for purposes of a deduction. The provision would increase revenue by $15.2 billion over a decade.

It would also modify a rule that specifies how reserves should be prorated between the company and shareholders for dividends received and reserve deductions. The provision would increase revenue by $0.6 billion over a decade.

The conference agreement would establish a special rule for distributions to shareholders from policyholder surplus accounts that were affected by a 1984 law. The provision would increase revenue by less than $50 million over a decade.

The legislation would modify the tax treatment of payments made upon the death of a policyholder after a life insurance contract has been sold or transferred to another entity. The provision would increase revenue by $0.2 billion over a decade.

Property and Casualty Insurance

The conference agreement would modify the rules that property and casualty insurance companies use in prorating certain deductions between the company and its reserves. The provision would increase revenue by $2.1 billion through fiscal 2027.

The agreement would also modify the rules used by property and casualty insurance companies for discounting unpaid losses. The provision would increase revenue by $13.2 billion over a decade.

Foreign Insurance

The measure would modify the tax treatment of income from overseas insurance companies. Under current law, shareholders in a “passive foreign investment company” are exempted from tax on its earnings if the company is predominantly engaged in insurance.

Under the bill, income would qualify for the exemption only if the insurance company would qualify for taxation as an insurance company in the U.S., and if its expenses, unearned premiums, and reserves constituted more than 25 percent of its total assets -- or 10 percent in certain circumstances.

The provision would increase revenue by $1.1 billion over through fiscal 2027.

Other Insurance Provisions

Policy acquisition expenses, such as commissions, would have to be amortized over 180 months, instead of 120 months under current law. Expenses would be considered the portion of a company's deductions that don't exceed 2.08 of net premiums of annuity contracts, 2.45 percent for group life insurance contracts, and 9.2 percent for other contracts. The provision would increase revenue by $7.2 billion in fiscal 2018 through 2027.

The measure would repeal a method that insurance companies can use to value their reserves that requires them to make special estimated tax payments. The provision would increase revenue by less than $50 million over a decade.

TAX-EXEMPT ORGANIZATIONS

Bonds

The conference agreement didn't adopt a proposal from the House bill to eliminate the tax exemption for interest on private activity bonds, which are used by state and local governments to finance projects led by private entities, such as airports or toll roads. It also doesn't include a House proposal to bar the use of tax-exempt bonds to finance construction of professional sports stadiums.

Interest on advance refunding bonds issued after 2017 would be taxable.

Refunding bonds are used by issuers to pay the principal, interest, or redemption price on an earlier bond. They are most often used to reduce issuers' interest costs.

Refunding bonds are classified as "advanced" when the bonds to be refunded remain outstanding for more than 90 days after the refunding bonds are issued.

The provision would increase revenue by $17.4 billion over fiscal years 2018 through 2027, according to JCT.

The conference agreement would bar the issuance of tax credit bonds after 2017. They're issued by state and local governments and provide holders with a federal tax credit in lieu of some or all of the interest payments that would normally be made by an issuer.

Types of tax credit bonds include those for renewable energy, energy conservation, school construction, and other education improvements. They are subject to different expiration dates and volume caps, some of which have been reached. Categories of bonds that hadn't expired or reached their volume cap as of 2018 would be affected by the change.

The provision would increase revenue by $0.5 billion over fiscal years 2018 through 2027, according to JCT.

Executive Compensation

The measure would impose a 21 percent excise tax on compensation greater than $1 million paid to any of the five highest-paid employees of tax-exempt organizations.

Compensation would include cash and the cash value of most benefits, including those that have vested but haven't been received by the employee. Compensation would also include payments contingent on the employee's separation that are at least three times the employee's base compensation -- also known "parachute payments" if the employee was considered "highly compensated," which could involve having an ownership stake.

Compensation paid to medical professionals and veterinarians wouldn't be taxed.

The provision would increase revenue by $1.8 billion in fiscal years 2018 through 2027, according to JCT.

Business Income

Tax-exempt organizations that also run multiple taxable businesses couldn't use losses from one of their business to offset the income from another business. The provision, which would be effective for losses incurred after 2017, would increase revenue by $3.5 billion through fiscal 2027.

Private Universities

The conference agreement would impose a 1.4 percent excise tax on the net investment income of endowments of private colleges and universities with a value of at least $500,000 per tuition-paying student. At least 50 percent of students would have to be located in the U.S.

Investment income of organizations related but not controlled by the institution would be treated as the institution's assets only if they were available for the institution's use.

State colleges and universities wouldn't be affected. The provision would increase revenue by $1.8 billion over a decade.

Alaska Native Corporations

The conference agreement would allow Alaska Native Corporations, which control the land and financial settlements made to Alaska Natives following the 1971 Alaska Native Claims Settlement Act, to transfer money and other property to an Alaska Native Settlement Trust without having to recognize gross income from those payments. The corporations could also deduct contributions made to the settlement trusts.

Corporations could exclude their payments to trusts beginning in the 2017 tax year.

The provision would reduce revenue by $0.1 billion in fiscal 2018 through 2027.

ALCOHOL TAX

The conference agreement would modify the tax treatment of certain beer, wine, and spirits by incorporating provisions similar to those of the “Craft Beverage Modernization and Tax Reform Act” (H.R. 747 and S. 236). The provisions would be effective in the 2018 and 2019 tax years.

The measure would:

- Exclude the aging period from the production period for beer, wine, or distilled spirits for purposes of determining whether a taxpayer can expense, rather than capitalize, interest costs paid or incurred during the production period.
- Reduce the excise tax rate for small brewers’ first 60,000 barrels of domestically produced beer, as well as the excise tax rate on the first 6 million barrels of domestically produced or imported beer by brewers of all sizes.
- Allow beer and spirits to be transferred between facilities owned by the same entity without incurring tax.
- Extend and modify a credit against the wine excise tax -- currently available to small domestic producers -- to all producers and importers, including sparkling wine producers.
- Increase to 16 percent from 14 percent the still wine alcohol by volume threshold subject to the lowest excise tax rate.
- Tax mead and certain sparkling wines at the lowest rate applicable to still wine.
- Establish a tiered excise tax on distilled spirits, instead of the current $13.50 per proof gallon rate.

The provisions would reduce revenue by $4.2 billion in fiscal 2018 through 2027, according to JCT.

OMITTED PROVISIONS

The final legislation omits additional provisions that were in the versions passed by the House or Senate. The final measure wouldn’t:

- Eliminate credits for electric vehicles and wind production.
- Extend and modify a tax credit for new nuclear production, which would have benefited Southern Co.
- Repeal the work opportunity and new markets credits, as well as one for disabled property access expenses.
- Modify the low income housing credit.
- Repeal deductions for unused business credits.
- Require taxpayers to use the first-in, first-out method for calculating the gain or loss from a sale of stock if they had acquired the stock at different dates in the past.
- Allow tax-exempt organizations to engage in political speech by suspending the “Johnson amendment.”

The measure also didn’t adopt proposals from the bills passed by the House and Senate related to U.S. possessions, including:

- Extending a deduction for production activities in Puerto Rico, a credit for certain businesses in American Samoa, and a temporary increase on the amount of excise tax on rum that is “covered over” or paid back to those Puerto Rico or the U.S. Virgin Islands (USVI).
- Clarifying source rules for determining whether income is considered to be from the U.S. or a U.S. possession.
- Modifying rules related to the capital gains of USVI residents.

To contact the analyst:
Sarah Babbage in Washington at sbabbage2@bloomberg.net

To contact the editors responsible:
Adam Schank at aschank1@bloomberg.net;
Loren Duggan at lduggan1@bloomberg.net