U.S. TAX REFORM – TAX CUTS AND JOBS ACT

December 5, 2017

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Contents

Timeline and Overview

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Timeline of Reform Legislative Path

HOUSE OF REPRESENTATIVES

Nov. 2:
Ways and Means Releases First Draft Bill

Nov. 9:
Ways and Means Finalizes Mark-Up

By Thanksgiving:
House Vote

SENATE

Nov. 9:
Senate Finance Chairman Release Bill

Pre-Thanksgiving:
Senate Bill Mark-Up, Amendments and Debate

After Thanksgiving:
Senate Vote

CONFERENCE COMMITTEE

December:
Resolve Differences. Send back to House and Senate for Vote

WHITE HOUSE

Before End of December:
Send to President for signature, veto, or non-action

January:
If signed, Treasury & IRS begin implementation

Most Impactful Corporate Provisions - A&M Tracker

TOPIC	DESCRIPTION	HOUSE Bill (11/16/17)	SENATE Bill (12/2/2017)
CORPORATE RATE REDUCTION	Corporate rate – 20%	√	√
PASS-THROUGH RATE REDUCTION	Lower rates applicable to income earned through partnerships, s-corporations, etc.	√	√
FULL CAPEX EXPENSING	Immediate 100% expensing of qualified capital expenditures	√	√
MODIFICATION OF NOL DEDUCTION	NOLs can only offset 90% of income, and NOL carrybacks are generally repealed	√	√
LIMIT ON INTEREST DEDUCTIBILITY	Limits interest deductibility for businesses, subject to certain exceptions	√	√
PARTICIPATION EXEMPTION SYSTEM	Foreign dividends paid by a foreign corporation to a U.S. 10% corporate shareholder are exempt	√	√
TOLL CHARGE FOR HISTORICAL E&P	Taxable deemed distribution of historic foreign E&P to U.S. 10% shareholders	√	√
CFC – MODIFIED STOCK ATTRIBUTION RULES	U.S. corporations deemed to own the stock of foreign shareholders constructively	√	√
TAXATION OF CERTAIN FOREIGN HIGH RETURNS	U.S. SH's of foreign subs subject to tax on foreign high returns or income derived from intangibles	√	√
EXCISE TAX ON CERTAIN PAYMENTS	Certain payments made by U.S. corporations to foreign corporations may be taxed at 20%	√	
TAXATION OF CAPITAL CONTRIBUTIONS	Capital contributions included in taxable income unless equal value equity given in exchange	√	
HOLDING PERIOD FOR CARRIED INTEREST	Three-year holding period to qualify for long term capital gain treatment for carried interest	√	
BASE EROSION AND ANTI-ABUSE TAX	Tax on certain outbound payments to related parties (i.e. an excise tax or base erosion tax)		√
FOREIGN-DERIVED INTANGIBLE INCOME	Allows a deduction for foreign-derived intangible income, subject to limitations		√
HYBRID PAYMENT DEDUCTION LIMIT	Denies a deduction for disqualified related party amounts paid or accrued		√
DEFINITION OF IP AMENDED (OUTBOUND)	Revises the definition of IP and confirms the authority to require certain valuation methods		√
INBOUND TRANFER OF IP FROM A CFC	New special rules for transfers of intangible property from a CFC to U.S. shareholders		√
REPEAL OF CORPORATE AMT	Repeals corporate AMT	√	

Core Provisions

Core Corporate Provisions - As Expected

PROVISION	HOUSE BILL	SENATE BILL
TAX RATES FOR CORPORATIONS	Rate would be cut from 35% to 20%. Amends the traditional domestic-to-domestic DRD, reducing the allowable deduction from 80% to 65%, and 70% to 50% for those with ownership of 20% or more, or less than 20% respectively. 100% deduction intact. Effective for taxable years beginning after December 31, 2017.	Generally the same as the House Bill. However, under the Senate Bill, the rate reduction would only be effective for taxable years beginning after December 31, 2018.
IMMEDIATE EXPENSING OF CAPITAL INVESTMENTS	Immediate deductions for CapEx available for the next five years, with exceptions for real property businesses. Requirement that assets be “original use” repealed. Applies to qualified property acquired and placed in service after September 27, 2017, and before January 1, 2023. Full expensing would not be allowed for any trade or business that has floor plan financing indebtedness.	Generally the same as the House Bill. However, under the Senate Bill the deductions are phased out beginning in taxable years starting after January 1 2023. They are reduced to 20% for property placed in service after December 31, 2025, and before January 1, 2027.
MODIFICATION OF NOL DEDUCTION	Only deduct NOL carryover to the extent of 90% of taxable income. Generally repeals all carrybacks (special exception for small businesses/farms).	Generally the same as House Bill. However, the 90% limitation is decreased to 80% for taxable years beginning after December 31, 2022.
LIMIT ON INTEREST DEDUCTIBILITY	Every business with average gross receipts >$25 million, regardless of form, will be subject to a limitation on net interest expense of 30% of adjusted taxable income (a proxy for EBITDA). Floor plan financing indebtedness is excluded from this limit. Disallowed interest deductions can be carried forward for 5 years.	Every taxpayer will be subject to a limitation on net interest expense of 30% of adjusted taxable income (a proxy for EBIT). Disallowed interest deductions can be carried forward indefinitely.
REPEAL OF DPAD	Under the provision, the deduction for domestic production activities would be repealed.	DPAD would remain for C corporations.

International Businesses / Structures - Bombshells

PROVISION	HOUSE BILL	SENATE BILL
TAXATION OF CERTAIN OUTBOUND PAYMENTS	20% excise tax on payments by U.S. companies to related foreign parties, unless the foreign party elects to treat the payment as effectively connected income (ECI). Payments to/from a partnership will be treated as received/made by its partners, and payments to/from a foreign corporation in connection with a U.S. trade or business will be treated received/made by a domestic corporation. If the foreign party elects to treat the payment as ECI, foreign profits associated with the payments would be subject to U.S. net income tax and potentially to Branch Profits Tax. Not applicable to interest paid, certain payments for services made at cost (i.e., without markup) and periodic payments subject to full withholding tax. Amounts subject to reduced withholding tax under a treaty may still be subject to the excise tax for the untaxed portion. Applies to International Financial Reporting Group's ("IFRG") when the average annual payments (for the last 3 years) from U.S. corporations to their foreign affiliates exceeds $100 million. Ability to apply a foreign tax credit up to 80% of foreign taxes.	U.S. corporations with gross receipts of at least $500 million are subject to what amounts to an alternative minimum tax computed on "modified taxable income, which is computed by adding back so-called "base erosion payments." The term "base erosion payment" generally means any amount paid or accrued to a related foreign person that is deductible or includible in the basis of depreciable property. Special provisions are included to deal with situations where the payment is also subject to a U.S. withholding tax or is made to an expatriated entity.
WORLDWIDE INTEREST EXPENSE CAP	Under the provision, the deductible net interest expense of a U.S. corporation that is a member of an international financial reporting group would be limited to the extent the U.S. corporation's share of the group's global net interest expense exceeds 110 percent of the U.S. corporation's share of the group's global earnings before interest, taxes, depreciation, and amortization (EBITDA).	Interest deductions are limited in the event that a U.S. company's debt exceeds what its debt would be if its debt-to-equity ratio were consistent with that of its worldwide group. Subjected companies would be allowed a ratio 130% greater than that of the worldwide group in 2018, reducing to 110% by 2022.

U.S. Multinationals and CFC Structures - More Surprises

PROVISION	HOUSE BILL	SENATE BILL
TOLL CHARGE FOR HISTORICAL E&P	A one-time toll charge would apply on previously unrepatriated earnings and profits of foreign subsidiaries.14% rate of tax on cash and cash equivalents and 7% rate on non-cash earnings and profits. May tax earnings and profits accumulated before U.S. shareholder acquired the foreign subsidiary. This provision applies to individual shareholders and to deferred earnings of certain non-CFCs. The liability would be payable over eight years with a partial foreign tax credit offset available.	Generally the same as the House Bill. However, the Senate Bill applies a 14.5% rate of tax on cash and cash equivalents and a 7.5% rate on non-cash earnings and profits. Additionally, the rate benefit built into the toll charge for previously deferred foreign income would be recaptured if the U.S. shareholder is a corporation that expatriates within 10 years from enactment.
PARTICIPATION EXEMPTION SYSTEM	The foreign-source portion of dividends received by U.S. corporations from their 10% or more owned foreign subsidiaries (excluding PFICs) would qualify for a full dividends received deduction. Does not apply to foreign income earned directly by the U.S. corporation or the capital gain portion of any disposition of such foreign subsidiaries.	Generally the same as the House Bill. However, under the Senate Bill, the exemption would not be available for earnings that received special foreign tax benefits (undefined at this point).
TAXATION OF CERTAIN FOREIGN HIGH RETURNS	U.S. 10% SH's of foreign subs would be subject to current U.S. tax on 50% of the U.S. 10% SH's foreign high returns. Foreign high returns are generated when foreign return on tangible assets exceeds 7% plus the federal short-term rate. A partial foreign tax credit would be available to offset this tax. The foreign tax credit component applies to 80% of the foreign high returns, compared to a 50% income inclusion for the U.S. 10% SH. As such, after foreign tax credit, this provision would likely only carry relevance to companies with very high foreign returns subject to very low local taxes.	U.S. companies are subject to tax on "global intangible low-taxed income." This provision applies to foreign subsidiaries of U.S. companies where the subsidiary income exceeds a 10% rate of return on tangible property. A foreign tax credit mechanism similar to the House Bill is available. This is very similar to the House's "foreign high-return" provision. However, the Senate Bill also allows for a deduction for certain returns attributable to sales and services provided by U.S. corporations to non-U.S. customers.

Other Structure Related Changes

PROVISION	HOUSE BILL	SENATE BILL
TAX RATES FOR NON-CORPORATE BUSINESS	Rate on certain business income of individual taxpayers that is generated through pass-through entities would be reduced to 25%. There are limitations and exceptions for professional services firms, owners actively involved in the business and certain items of income (i.e., dividends and capital gains) unrelated to the business needs that are ineligible for the 25% rate.	A 23% deduction can be claimed on income earned through a flow-through entity, with certain limitations. The remaining flow-through income will be taxed at the taxpayers individual rates.
CFC – MODIFIED STOCK ATTRIBUTION RULES	For purposes of determining whether a foreign corporation is a CFC, domestic entities (corporations, partnerships, estates, trusts) are deemed to constructively own any shares owned by their shareholders, partners or beneficiaries, as the case may be. For example, where a foreign parent company owns foreign subsidiaries and also owns a domestic corporation or a domestic partnership, the domestic entity(ies) will be deemed to own the foreign subsidiaries, making them CFCs, thereby subjecting them to the rules of Subpart F. In that case, any U.S. 10% shareholder of the foreign parent would be required to include its pro rata share of the Subpart F income of the foreign subsidiaries, including the new Subpart F income category for “foreign high returns.”	See House Bill

Other Notable Provisions

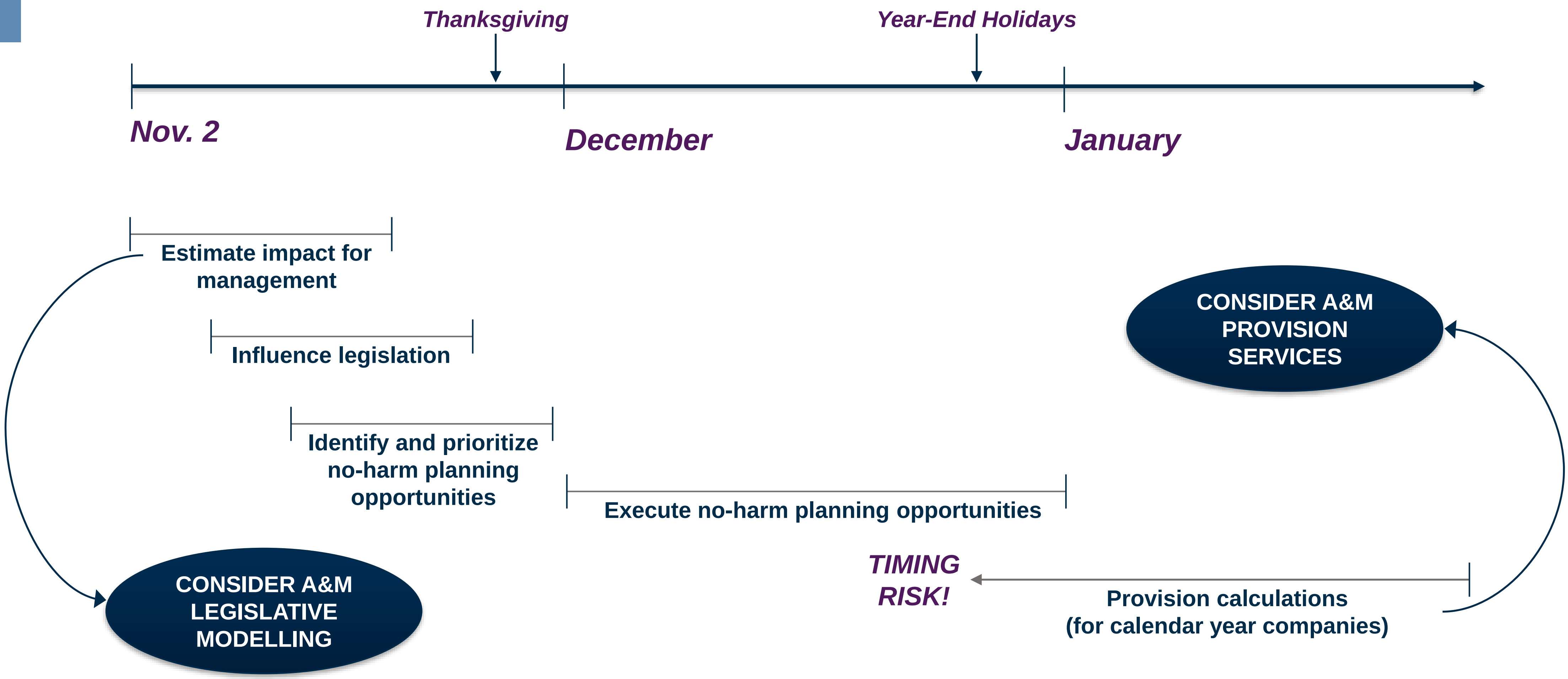
PROVISION	HOUSE BILL	SENATE BILL
LIKE-KIND EXCHANGES OF REAL PROPERTY	The Deferral of gain on like-kind exchanges would be modified to only apply to exchanges of real property.	See House Bill
TAXABLE CONTRIBUTIONS TO CAPITAL	This provision would treat capital contributions as taxable income. It would apply to all capital contributions except to the extent the contribution is made in exchange for shares (or other ownership interests) of equal value.	Not in Senate Bill
REPEAL OF CORPORATE AMT	Corporate AMT is repealed.	Not in Senate Bill
DISALLOW DEDUCTION FOR ENTERTAINMENT EXPENSES	No deduction would be allowed for entertainment, amusement or recreation activities, facilities, or membership dues relating to such activities or other social purposes. Additionally the deduction for certain fringe benefits would be disallowed. The current 50-percent limitation would apply only to expenses for food or beverages and to qualifying business meals.	Generally the same as the House Bill. However, under the Senate Bill, the 50% deduction for food and beverage would be expanded to include expenses associated with providing food and beverage through an eating facility that meets certain requirements.
LIMIT ON EXCESSIVE EMPLOYEE REMUNERATION	Under this provision, the exceptions to the $1 million deduction limitation for commissions and performance-based compensation would be repealed.	See House Bill

Other Notable Provisions

PROVISION	HOUSE BILL	SENATE PLAN
EXCISE TAX ON EXECUTIVE COMPENSATION	A tax-exempt organization would be subject to a 20-percent excise tax on compensation in excess of $1 million paid to any of its five highest paid employees.	See House Bill
FOREIGN-DERIVED INTANGIBLE INCOME	Not in House Bill	A new deduction equal to 37.5% of foreign-derived intangible income appears to be create a 12.5% effective U.S. tax rate for non-routine earnings attributable to export sales and services.
HYBRID PAYMENT DEDUCTION LIMIT	Not in House Bill	New hybrid transaction rules (ala the BEPS initiative): deductions may be disallowed for interest and royalty payments to related parties where the recipient is not subject to local tax on the corresponding income.
DEFINITION OF IP AMENDED (OUTBOUND)	Not in House Bill	The definition of intangible property for purposes of outbound transfers of IP is expanded to include workforce in place, goodwill, and going concern value.
INBOUND TRANSFERS OF IP FROM A CFC	Not in House Bill	Foreign-held IP may be distributed to a US parent with little or no U.S. tax. The amount of the distribution would be determined by reference to adjusted basis, rather than fair market value, with the U.S. parent taking over the tax basis the CFC had in the IP.
G/L ON SALE OR EXCHANGE OF PARTNERSHIP TREATED AS ECI	Not in House Bill	A foreign partner would have effectively connected income from the sale of interest in a U.S. partnership to the extent the gain is attributed to U.S. trade or business assets of the partnership (would overrule 'Grecian Magnesite' decision).

Actions To Consider

A Short Window to Prepare and Act



Efforts to Take During Legislative Action

With a bill potentially signed into law in early 2018, taxpayers will likely have a very short window of time to calculate the impact of the law changes that will be reflected on Dec. 31^{st} provisions.

SOME OF THE EFFORTS THAT CAN BE TAKEN <u>NOW</u> TO BE READY IN JANUARY INCLUDE:

CALCULATING FOREIGN E&P AND TAX COST ASSOCIATED WITH A TOLL-CHARGE

REVIEWING HISTORICAL NON-U.S. INCOME TAX PAYMENT TO SUPPORT FTC AGAINST TOLL-CHARGE

ANALYZING THE MAGNITUDE OF POTENTIAL INTEREST DEDUCTION LIMITATIONS, INCLUDING:

- *Calculating limitation under EBITDA projections*
- *Examining global debt profile of multinational group and relative EBITDA contributions*

CALCULATING THE IMPACT ON DTAS AND DTLS FROM CHANGE IN CORPORATE TAX RATE

ESTIMATING THE REALIZABILITY OF TAX ATTRIBUTES UNDER NEW TAX REGIME

CONSIDER POSSIBLE CHANGES IN TAX YEAR ENDS TO DELAY OR ACCELERATE THE EFFECTIVE DATE OF VARIOUS PROVISIONS

How A&M Can Help

PROVIDE UPDATES ON DEVELOPMENTS THROUGHOUT THE LEGISLATIVE PROCESS

PROVIDE INSIGHT FROM OUR CONTACTS IN WASHINGTON, D.C.

DISCUSS HOW THE PROPOSED LEGISLATION WOULD IMPACT YOUR BUSINESS

MODEL OUT HOW THE PROPOSED LEGISLATION WOULD IMPACT YOUR BUSINESS

DISCUSS NECESSARY CHANGES FOR PROVISION PLANNING, AS WELL AS OTHER FINANCIAL ACCOUNTING INTRICACIES

PROVIDE ADVANCED TAX PLANNING ADVICE IN RESPONSE TO THE PROPOSED LEGISLATION

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Disclaimer

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