TAX ALERT

HOUSE WAYS AND MEANS COMMITTEE APPROVES TAX CUTS AND JOBS ACT WITH LIMITED CHANGES

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On November 9, 2017, in what is shaping up to be a dramatically condensed legislative process, the House Ways and Means Committee approved the amended Tax Cuts and Jobs Act ("TCJA") bill (HR 1) by a 24-16 party line vote. With the TJCA passing out of Committee, the full House is anticipated to vote on the proposed legislation as early as next week.

In large part, the bill leaves the Committee substantially similar to its original version released on November 2nd (see our Tax Alert "House GOP Unveils Tax Overhaul Details" dated November 7, 2017 for a summary of the original version), with changes made mostly to rates and specific technical details rather than sweeping concepts. Some of the more significant changes are outlined below.

Notable November 6th Amendments

- **Carried Interest.** A three-year holding period requirement in order to obtain long-term capital gain rates with respect to partnership interests received in connection with the performance of services was included in the amended bill.
- **Equity Based Compensation.** A provision allowing certain employees of privately held entities to elect to defer income for a 5 year period on exercise of certain stock options and restricted stock units received as compensation for services was inserted.
- **International Tax – Base Erosion** Various changes to the international base erosion rules, including:
  - Taxation of affiliated payments is revised to provide a foreign tax credit, as well as modify the calculation of the affiliate's income subject to the excise tax;
  - Taxation of foreign high returns is amended to clarify the scope of certain exceptions for local activities; and
  - Clarification of the method of computation for the deemed repatriation tax on deemed paid grossed-up foreign taxes.

Notable November 9th Amendments

- **Maximum Rate for Business Income of Small Business Owners**. This amendment introduces a 9% tax rate applicable to the first $75,000 ($37,500 for unmarried individuals) of net business income earned by an active stakeholder in a pass-through business where the owner earns less than $150,000 ($75,000 for unmarried individuals) from the pass-through entity. This benefit is fully phased out once the owner earns $225,000, and would be implemented over a 5 year period, with 2018-19 eligible for an 11% rate, 2020-21 eligible for a 10% rate, and the full reduction in effect for years on or after 2022.
- **Adoption Expenses**. The House opted to remove the provision that repealed the non-refundable credit for qualified adoption expenses, and this item would now be preserved as it is under current law.
- **S Corporation Conversions into C Corporations**. Distributions from an eligible terminated S corporation would be treated as paid from its Accumulated Adjustments Account (previously taxed S corporation earnings) and C corporation earnings & profits on a prorata basis. Under this proposal, distributions will be partially non-taxable until the terminated S corporation's accumulated adjustments account is fully distributed.
- **Nonqualified Deferred Compensation.** The amendment preserves the existing tax treatment for nonqualified deferred compensation.
- **Dividends Received Deduction.** As an equalization measure, the amendment reduces the deduction permissible by a corporation with respect to dividends it receives from corporations. The 70% rate available to corporations owning less than 20% of a corporation's stock would be reduced to 50%, and the 80% rate available to corporations owning more than 20% and less than 80% would be reduced to 65%. There would be no change to the 100% exclusion for dividends received from wholly-owned subsidiaries.
- **Research Expenditures**. For certain research expenditures incurred for research within the United States in taxable years beginning after 2023, a business will be required to amortize the amount over a 5-year period. For research performed outside of the United States, the relevant amortization period will be 15 years.
- **Qualified Equity Grants.** The amendment clarifies that Restricted Stock Units (RSUs) will not be eligible for the Section 83(b) election as a result of the proposed bill, and the application of Section 83 to RSUs would be limited to the deferral mechanism implemented by new Section 83(i).
- **Transition to Participation Exemption.** Tax rates applicable to deemed-repatriation income arising as a

result of the transition to a participation exemption system are increased by the amendment. In lieu of a 12% rate on cash and cash equivalents, and a 5% on the remainder, the amendment imposes tax at a rate of 14% and 7%, respectively.
- **Excise Tax on Payments to Related Foreign Corporations.** The second amendment further modifies the excise tax rules with regard to payments made to related foreign corporations. It eliminates the mark-up on deemed-expenses and expands the foreign tax credit to 80%, while at the same time altering the definition of foreign taxes paid to reference the general definition provided under current law Section 906.

As the bill moves through the legislative process, there could be many changes as a result of compromises needed to assure the bill's passage. Mazars USA LLP will continue to monitor the bill's progress and report accordingly. A detailed analysis of the impact of the bill will be issued once it is enacted into legislation, an event that could potentially occur as early as mid-December.

Please contact your Mazars USA LLP professional for additional information.

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