KNAV

PARTNERS BEYOND BOUNDARIES

US tax thought leadership | November 22, 2017

This thought leadership provides an update on the tax reforms proposed by the House Ways and Means Committee and the Senate Finance Committee and their impact on the US corporations.

Shishir Lagu
Partner, US Taxation

On November 2, 2017, House Ways and Means Committee released the proposed "Tax Cuts and Jobs Act of 2017". The bill aims to overhaul the US Tax Code by changing the tax rates, incentives, deductions and various other provisions for individuals as well as businesses. The proposal was approved by the Ways and Means Committee on November 9 after incorporating the Chairman's amendments of Nov. 6 and Nov. 9. The House Bill was passed on November 16, 2017 by a vote of 227-205.

On November 9, 2017, the Senate Finance Committee headed by Orrin Hatch also released a detailed description of its tax reform proposal named "The Chairman's mark of the "Tax Cuts and Jobs Act of 2017". Chairman Hatch subsequently released a modification to the chairman's mark on November 14, and proposed an additional 'manager's amendment' on November 16. Senate bill was approved by the Senate Finance Committee late night on November 16 by a party-line vote of 14-12. The Senate bill is expected to be brought to the floor for debate and vote after the Thanksgiving holiday.

Assuming the Senate bill passes, the Conference committee will work to reconcile the two bills that have many subtle and glaring differences.

This article provides a comparison between House Ways and Means Committee's plan and the Senate plan approved by House and Senate respectively on November 16, 2017.

Although there are significant tax reforms on an individual tax front as well, this article aims at presenting certain key corporate tax reforms and their impact.

Topic	House Ways and Means Committee (HWMC)	Senate Finance Committee (SFC)	Observation
Domestic tax provisions			
Corporate Tax Rate	• For tax years effective on or **after January 1, 2018,** the corporate tax rate would be reduced to 20% and tax rate for personal service corporations would be 25%.	• For tax years effective **after December 31, 2018**, the corporate tax rate would be reduced to 20%. The proposal eliminates the special	• The proposed significant reduction in tax rate will provide a relief to US corporations which are being currently taxed at 34% or 35%.

		tax rate for personal service corporations.	• Both committees propose the same rates, however the SFC bill proposes that the reduced rates would be effective one year later.
Alternative Minimum Tax	• Effective on or after January 1, 2018, alternative minimum tax would be repealed. • However, taxpayers with AMT credit carryforward would be able to claim a refund of 50% of remaining credits in 2019, 2020, and 2021 (to an extent that credits exceed regular tax for that year). • Any credit remaining thereafter, would be refunded in 2022.	• Effective on or after December 31, 2017, alternative minimum tax would be repealed. • **The proposal 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 2017 and before 2022 in an amount equal to 50 percent (100 percent in the case of taxable years beginning in 2021) to an extent that credits exceed regular tax for that year.	• This provision will provide relief to taxpayers who did not have regular tax liability but were still taxed per the Alternative Minimum Tax provisions. • The AMT carried forward, would not be available for setoff against regular taxes and would have to be claimed as a refund in phased manner per the HWMC bill. • Whereas, per the SFC bill, the AMT credit can be used to offset regular tax liability and any unused credit thereafter, will be refunded in phased manner, similar to HWMC bill.
Net operating loss	• Net operating losses would be allowed to be carried forward indefinitely, but carryback of losses would be eliminated. • NOL deduction would be restricted to 90 percent of taxable income before NOL deduction. • **NOLs carried forward would need to be increased by an annual interest factor.**	• Net operating losses would be allowed to be carried forward indefinitely, but carryback of losses would be eliminated. • Till tax years 2022, NOL deduction would be restricted to 90 percent of taxable income before NOL deduction. For tax years beginning after 2022, the NOL deduction would be limited to 80 percent of taxable income.	• The utilization of NOLs would be restricted. • At any given point of time, the taxpayer will have to shell out atleast 2% of its taxable income as regular taxes. This will have the same effect as the current Alternative Minimum Tax, which itself is proposed to be repealed (as discussed in previous point). • The NOL utilization limit would further be reduced to 80% of the taxable income after 2022.

			• Indefinite carryforward period will be helpful for businesses with long gestation period. • Annual interest factor is introduced to accommodate the inflation impact on NOLs in the HWMC bill however, the SFC bill does not include this provision.
Method of accounting	• Beginning December 31, 2017, corporations and partnerships (with corporate partners) with average gross receipts of up to $ 25 million (indexed for inflation) would be allowed to use the cash method of accounting. • Also, the UNICAP rules under IRC section 263A would not apply to real and personal property acquired or manufactured by such business.	• Beginning December 31, 2017, corporations and partnerships (with corporate partners) with average gross receipts of up to $ 15 million (indexed for inflation) would be allowed to use the cash method of accounting. • Also, the UNICAP rules under IRC section 263A would not apply to real and personal property acquired or manufactured by such business.	• The increased threshold will make it easier for small businesses to continue using cash method of accounting and also, be exempted from the rigors of the UNICAP rules. • HWMC proposes average gross receipt threshold of $ 25 million whereas, the SFC bill proposes a threshold of $ 15 million.
Bonus depreciation	• Per the proposed bill, taxpayers would be able to immediately deduct 100 percent of the cost of qualified property acquired and placed in service after September 27, 2017 and before January 1, 2023. • The bill expands the property that is eligible for this immediate expensing by repealing the requirement that the original use of the property begin with the taxpayer, provided that the property was not used by the taxpayer before the taxpayer acquired it.	• The proposal 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 placed in service after September 27, 2017, and before January 1, 2023.	• This provision will enable taxpayers to claim bonus depreciation of 100% of the cost of the property. • This deduction is being presented as tax incentive for corporations (manufacturing sector likely to be the biggest beneficiary) to undertake capital investments in depreciable assets. • Additionally, entitlement to used assets for 100% bonus depreciation may be beneficial where the assets are acquired in an asset or deemed asset acquisition (say 338(h)(10)).

			• However, SFC bill proposes bonus depreciation be permitted only on new assets.
IRC section 179	• Effective for tax years **2018 through 2022**, the bill would increase the **business expensing limitation to $5 million** and the **phase out amount to $20 million**. • The new limits would be adjusted for inflation.	• **For tax years beginning after** • **2017**, the proposal increases the maximum amount a taxpayer may **expense under IRC section 179 to $1 million** and increases the **phase-out threshold amount to $2.5 million.** • The new limits would be adjusted for inflation.	• Under the current rules, the limit for business expensing is $500,000 and the phase out amount is $2 million. Increasing these limits will enable taxpayers to get an accelerated deduction for capital investments under IRC section 179. • Although, the limits proposed under SFC bill are significantly lower as compared to the HWMC bill.
Interest expense	• The bill would cap net business interest expense deduction at 30 percent of a business's adjusted taxable income, effective for tax years beginning after 2017. • Business interest, which is not otherwise allowed as a deduction because of IRC section 163(j) can be **carried forward for 5 years.** • IRC section 381(c) will be amended to include disallowed business interest as a tax attribute thereunder, and conforming amendments will be made under section 382 to treat disallowed business interest as a pre-change loss under subsection (d). • This provision would not apply to a business with average gross receipts of **$25 million or less.**	• The limit on deduction of interest expense is the same as that proposed in HWMC bill. • The definition of adjusted taxable income is taxable income without regard to certain deductions, but importantly, does not consider an 'add back' for depreciation or amortization which is the current case. • Business interest, which is not otherwise allowed as a deduction because of IRC section 163(j) can be **carried forward indefinitely.** • Any carryforward of disallowed interest is an item taken into account in the case of certain corporate acquisitions described in	• Interest expense allowed as deduction would be further reduced to 30% of adjusted taxable income, from the current limit of 50% under IRC section 163(j). • The modification to the definition of adjusted taxable income, in the SFC bill will significantly lower the interest deduction for the taxpayers claiming huge tax depreciation & amortization deduction. • Moreover, section 163(j) is applicable only to thinly capitalized corporations, while proposed provision does not specify whether it is applicable only to thinly capitalized corporations or all. The SFC bill proposes indefinite carry forward similar to current rule,

	• Deductible net interest expense of a U.S. corporation that is a member of an "international financial reporting group" would be limited based on U.S. corporation's share of group's EBITDA.	section 381 and is subject to limitation under section 382. • This provision would not apply to a business with average gross receipts of **$15 million or less.** • For any domestic corporation, that is a member of a worldwide affiliated group, the proposal reduces the deduction for interest paid or accrued by the corporation by the product of the net interest expense of the domestic corporation and the debt-to-equity differential percentage of the worldwide affiliated group.	whereas the HWMC bill restricts carry forward to 5 years. • Further, disallowed interest carryover shall be treated as tax attribute subject to limitation under IRC section 382 upon change of control. • A different mechanism for calculating additional limitation on a taxpayer who is a member of an international financial reporting group has been proposed under both the bills.
Amortization of Research and Experimental Expenditures	• Beginning after Dec. 31, 2022, research or experimental expenditures, including software development expenditures, must be capitalized and amortized over a 5-year period (15 years if expenditures are attributable to foreign research). • Land acquisition and improvement costs and mine exploration costs would not be subject to this rule.	• Beginning after Dec. 31, 2025, research or experimental expenditures, including software development expenditures, must be capitalized and amortized over a 5-year period (15 years if expenditures are attributable to foreign research).	• Per the current rules, a taxpayer may either treat research or experimental expenditures as expenses or charge it to capital account and amortize it over a period of 60 months. • The HWMC bill mandates capitalization of research or experimental expenditures. The option to expense off has been eliminated and time span for amortizing foreign research increased to 15 years instead of current 5 years.
Deductions for Income Attributable to	• The bill would repeal the deduction for domestic production activities under IRC section 199, **effective for tax years beginning after 2017.**	• The bill would repeal the deduction for domestic production activities under IRC section 199, effective for	• The deduction benefit available to manufacturers for domestic production activities will no longer be available. The overall impact on

Domestic Production Activities		tax years **beginning after December 31, 2018**.	effective tax rate due to this would be approximately 1.8% (9% of taxable income * 20% tax rate). • There is a difference in the effective dates under both the bills.
Entertainment and similar expenses	• Per the proposal, no deduction will be allowed for entertainment, amusement or recreation activities, facilities, or membership dues.	• Similar provision as HWMC bill.	• The 50-percent limitation under current law would continue to be applicable to expenses for food or beverages and to qualifying business meals, but no deduction would be allowed for other entertainment expenses.
Like-kind exchanges	• The gain deferral provision of like-kind exchange would be applicable only in case of real property.	• The plan would limit the non-recognition of gain in the case of like-kind exchanges to real property that is not held primarily for sale.	• Under the current law, like kind exchange provision is applicable to personal property as well.
Business credits	• The bill proposes to either repeal or limit business credits like clinical testing, work opportunity tax credit, new markets tax credit, certain energy credits, credit for plug-in electric vehicles, etc., that are available under the current law. • Research & Development credit, however, would be preserved. • This proposal repeals the deduction for certain unused business credits after the end of the carry forward period.	• This bill does not provide reference to tax credits except rehabilitation credit and clinical testing credit. • Research & Development credit, however, would be preserved. • This proposal repeals the deduction for certain unused business credits after the end of the carry forward period.	• The taxpayers will not be able to get the benefits of various tax credits which will in turn affect their effective tax rate. However, preserving R&D credit will be a big incentive for corporations that invest heavily in R&D activities. • Unlike HWMC bill, the SFC bill does not specify about a few other business credits.
Dividend received deduction	• After 2017, the proposal would reduce the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent.	• After 2018, the proposal would reduce the 70 percent dividends received deduction to 50 percent and the 80 percent dividends received deduction to 65 percent.	• This reduction is mainly to reflect the lower corporate tax rates. • Effective dates differs under both the bills.

Contributions to Capital	• Beginning from the date of enactment, contributions to capital of a corporation would be included in corporation's gross income unless exchanged for stock. • Contributions in excess of fair market value of stock issued would be included in gross income of Transferee Corporation. • Basis in property contributed to capital would be greater of either basis of transferor increased by gain recognized, or amount included in gross income.	• No specific provision in the SFC bill.	• IRC section 118 would be repealed. • It is unclear how this proposed amendment would apply to contributions to capital which have historically qualified for section 351 or similar non-recognition provisions without actual issuance of stock.
International Tax provisions			
Dividend received deduction for foreign source dividend and one-time tax on repatriation.	• The bill provides 100% deduction for foreign-source portion of dividends received from "specified 10-percent owned foreign corporations" by U.S. shareholders, subject to a six-month holding period. • Additionally, it proposes tax (up to 7% or 14%) on foreign earnings that were still deferred as of the subsidiaries' last tax years ending before 2018. • Taxpayers may elect to pay resulting liability over 8-year period in equal annual installments.	• Similar provisions as HWMC bill except , it proposes tax (up to 5% or 10%) on foreign earnings that were still deferred as of the subsidiaries' last tax years ending before 2018.	• Dividend received deduction has been expanded to include dividend from foreign corporations. • Additionally, one-time tax at lower rate has been proposed for already accumulated E&P. • The proposed reform may encourage multinationals to repatriate such foreign profits to the US & re-invest these profits to generate more jobs in the US.
Underlying Foreign Tax Credit	• No foreign tax credit or deduction would be allowed for any taxes paid or accrued with respect to any dividend to which the dividend received deduction under the bill would apply.	• Similar provision as HWMC bill.	• Since qualified foreign-source dividend is not subject to tax, underlying foreign tax credit would be repealed.
Limitation on losses with respect to 10-percent-	• A U.S. parent would reduce the basis of its stock in a foreign subsidiary by the amount of any exempt dividends received by the U.S. parent from its foreign	• Similar provision as HWMC bill.	• Dividend received will be reduced from the basis only for purpose of calculating loss on sale. It will not be reduced if there is a gain scenario.

owned foreign corporations	subsidiary – but only for purpose of determining the amount of loss on any sale or exchange of the foreign subsidiary's stock by its U.S. parent.		
Limitation of treaty benefits	• The Chairman's mark removed the amendment to IRC section 894 included in original bill. • Per the original bill, the reduced rate of withholding under an income tax treaty was not permitted with respect to an "interest payment to an entity which is controlled by the same foreign parent" unless the withholding tax would have been reduced by a treaty if the payment had been made directly to the foreign parent.	• No such provision in the bill.	• Based on Chairman's mark in HWMC and non-inclusion of such provision in SFC, it seems that this harsh amendment is no longer expected to be enacted
Current year inclusion by United States shareholders with foreign high returns	• Under the proposal, a U.S. parent of one or more foreign subsidiaries, will be subject to current U.S. tax on fifty percent of the U.S. parent's foreign high returns. Foreign high returns would be measured as the excess of the U.S. parent's foreign subsidiaries' aggregate net income over a routine return (7 percent plus the Federal short-term rate) on the foreign subsidiaries' aggregate adjusted bases in depreciable tangible property, adjusted downward for interest expense.	• U.S. shareholders of CFCs would be subject to current U.S. taxation on "global intangible low-taxed income" (GILTI) with a deduction for foreign-derived intangible income. Basis adjustment rules apply for transfers of intangible property from CFCs to U.S. shareholders.	• This provision is intended to prevent erosion of US tax base. The provision would lead to inclusion of 50% of a US shareholder's pro rata share of the aggregate CFC net income, not currently subject to US tax, if it exceeds a set percentage of the US shareholder's pro rata share of the aggregate tangible depreciable asset basis of all its CFCs. • Against this inclusion, the Bill would permit the US shareholder an indirect foreign tax credit for up to 80% of the CFCs' foreign taxes attributable to shareholder's such income.

Taxes on base erosion payments.	• The bill would impose an excise tax on certain payments from domestic corporations to related foreign corporations. • Under the proposal, payments (other than interest) made by a US corporation to a related foreign corporation that are either deductible, includible in costs of goods sold, or includible in the basis of a depreciable or amortizable asset would be subject to a 20-percent excise tax, unless the related foreign corporation elects to treat the payments as income effectively connected with the conduct of a US trade or business. Thus, the foreign corporation's net profits (or gross receipts if no election is made) with respect to those payments would be subject to full US tax. • Exceptions would apply for intercompany services, which a US company elects to pay for at cost (that is, no markup) and certain commodities transactions. • Exception also provided for international financial reporting groups, which have payments exceeding USD 100 million, made by U.S. corporations to their foreign affiliates during the current and two preceding years.	• The bill would impose base erosion minimum tax, to an applicable taxpayer for any taxable year, which 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. • Denial of deduction for certain related-party amounts paid or accrued in hybrid transactions or with hybrid entities. • The bill provides a detailed explanation on applicability and determination of this tax.	• This proposal would impose full US tax on common business transactions including royalties paid to, services received from and inventory purchased from foreign affiliates. • It would have an adverse impact on large multinationals, both US- and foreign-parented. • According to JCT, this provision would increase revenues by $154.5 billion over 2018-2027. • Relief is available for smaller business groups which do not have transactions / payments from US entities to foreign related parties exceeding USD 100 million in the HWMC bill. • There have been reports of strong opposition to this provision and we understand that House Ways and Means Committee is actively considering modifications to this provision of the Bill. Infact, the SFC bill seems to already modify the mechanism for this tax. We will have to wait and watch how this provision finally pans out.