JONES DAY

COMMENTARY

NOVEMBER 2017

IN SHORT

The Situation: On November 2, 2017, the House Ways and Means Committee released its first draft of much-anticipated comprehensive U.S. tax reform legislation as the "Tax Cuts and Jobs Act." Chairman Brady's markup of the bill was released today.

The Result: Far-reaching changes are proposed to individual, business, and international taxation.

Looking Ahead: The House Ways and Means Committee plans to begin marking up the bill on November 6. The Senate is expected to release its own tax bill shortly. After reconciliation between the House and Senate bills, President Trump hopes to sign the legislation before Christmas.

SKIP TO THE FULL VERSION >>

On November 2, 2017, the House Ways and Means Committee released its draft of the "Tax Cuts and Jobs Act." This *Commentary* summarizes certain key provisions of the bill, most of which would be effective for taxable years beginning after December 31, 2017.

Individual Tax Reform

Tax Rates
The number of individual tax rate brackets would be reduced from seven to four: 12 percent, 25 percent, 35 percent, and 39.6 percent, and the income threshold subject to the 39.6 percent bracket would be increased to $1 million for taxpayers filing jointly and $500,000 for other individuals.

Deductions
The state and local income tax deduction would be eliminated, the property tax deduction would be limited to $10,000 for joint filers and unmarried individuals, and the deductibility of interest on principal residence mortgage indebtedness would be limited to new mortgages of no more than $500,000, down from $1 million, and mortgage interest deductions would be eliminated on second residences.

> “The corporate tax rate would be changed from a graduated rate structure with a maximum rate of 35 percent to a flat 20 percent rate.”

Executive Compensation

Executives' ability to defer the taxation of compensation and companies' ability to deduct executive compensation would be severely curtailed.

Business Tax Reform

Corporate Tax Rate
The corporate tax rate would be changed from a graduated rate structure with a maximum rate of 35 percent to a flat 20 percent rate.

Pass-Though Business Income
Individual owners of a trade or business (including ownership through pass-through entities) would be subject to a reduced tax rate of 25 percent on "passive" business income derived from such trade or business. For this purpose, passive business income means return on invested capital and no material participation (generally looking to the number of hours the taxpayer spends each year participating in the activities of the business) in the business (other than certain rental activities). Active income (including wages) would continue to be subject to ordinary tax rates.

Expensing/Depreciation
Temporarily, taxpayers would be permitted to fully "expense" (i.e., take a 100 percent deduction for) many types of business property but not including most intangible property. Taxpayers could not expense many longer-lived assets and other nonqualifying business assets. These expensing changes are temporary only; the rule would only apply to property acquired after September 27, 2017, and

placed in service before January 1, 2023.

Elimination of Business Tax Credits
Several business tax credits would be repealed, including the orphan drug credit, the employer-provided child care credit, the rehabilitation credit, the work opportunity credit, and the credit for expenditures to provide access to disabled individuals. No additional new markets tax credits would be allocated after 2017.

Limitations on Interest Deductions
Businesses would be subject to a limitation on deducting interest expense. No deduction would be allowed for net interest expense in excess of 30 percent of the business's adjusted taxable income. Domestic corporations that are members of "international financial reporting groups" would also be limited in their ability to deduct net interest expense based on EBITDA.

U.S. International Tax Reform

Territorial System of Taxation
Dividends received by a U.S. corporate shareholder from a 10 percent-owned foreign corporation out of its foreign source earnings would be 100 percent deductible, provided that the distributor's stock had been held by the U.S. shareholder for at least 180 days.

Mandatory Taxation of Foreign Earnings
Accumulated foreign earnings determined as of (i) November 2, 2017, or (ii) December 31, 2017, (whichever is greater) would be subject to a one-time tax at a rate of 12 percent (to the extent of foreign cash) or 5 percent otherwise. Foreign cash would be equal to the average of the cash held on (i) November 2, 2017; (ii) the close of the last tax year ending prior to November 2, 2017; and (iii) the close of the second-last tax year ending prior to November 2, 2017. The tax could be paid over eight years at the taxpayer's election.

Current Taxation of Certain Foreign Income
Fifty percent of a controlled foreign corporation's ("CFC's") "foreign high return amount" would be subject to current U.S. tax. The foreign high return amount would equal the CFC's net income, minus the amount by which approximately 8.5 percent (7 percent plus the short-term applicable federal rate) of basis in depreciable tangible property exceeds interest expense.

Excise Tax on Outbound Payments
Domestic corporations would be subject to a 20 percent excise tax on deductible payments made to related foreign members (i.e., members of the same international financial reporting group that file consolidated financial statements and that in the aggregate would report an average over the immediately preceding three years of $100 million or more in payments subject to this excise tax). In lieu of paying the excise tax, an election could be made to treat the foreign member's income as effectively connected with a U.S. trade or business; although expenses would be limited to the group’s net income ratio, resulting in a higher tax base.

Looking Forward

The House Ways and Means Committee plans to begin marking up the bill next week. The Senate is also expected to release its own tax reform bill next week, which may differ significantly from the House bill. The House hopes to pass its bill before the holiday recess that begins on November 20, and the Senate hopes to follow soon thereafter. President Trump has announced his desire to have tax legislation signed into law "before Christmas."

FOUR KEY TAKEAWAYS

1. The "Tax Cuts and Jobs Act" potentially brings sweeping reforms to the U.S. tax code.
2. The number of individual tax rate brackets would be reduced from seven to four, and substantial new limits are proposed for itemized deductions.
3. Corporate tax rates would be set at a flat 20 percent rate. Alterations to expensing and depreciation allowances are also in the bill.
4. Reforms to the U.S. international tax system include a transition to a territorial system, provisions for the taxation of accumulated foreign earnings, and other changes.

WANT TO KNOW MORE?
READ THE FULL VERSION.

AUTHORS


Joseph A. Goldman
Washington

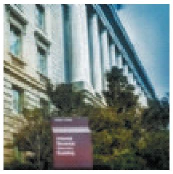

Edward T. Kennedy
New York


Andrew M. Eisenberg
Washington

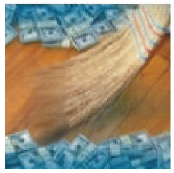

Raymond J. Wiacek
Washington

All Contacts >>>

YOU MIGHT BE INTERESTED IN: Go To All Recommendations >>



IRS Opens Pilot Program on Tax-free Spin-offs



U.S. Tax Reform Proposal Highlights Potential Sweeping Changes

SUBSCRIBE SUBSCRIBE TO RSS

Jones Day is a legal institution with more than 2,500 lawyers on five continents. We are One Firm Worldwide℠.