The long-awaited tax reform bill: Initial reactions

• **What was expected**
  - Rate reductions for individuals and businesses
  - Estate tax and AMT repeal
  - Limitations on interest deductibility
  - Many other revenue raisers pulled from Camp (H.R. 1 from 2014)

• **Some surprises**
  - Nothing on LIFO and advertising costs
  - Limits on mortgage interest deduction
  - No change to investment tax rates (capital gains/qualified dividend income)

• **Some challenges**
  - State and Local Tax (SALT) has strong supporters in high tax states
  - Deficit hawks (especially in the Senate)
  - Small business concerns about narrow nature of pass-through income that gets 25% rate
  - Byrd rule compliance – must not increase the deficit (beyond the $1.5T allowed in the first decade)
# Tax Cuts and Jobs Act (HR 1)
## Business taxation

<table>
<thead>
<tr>
<th></th>
<th>Current law</th>
<th>House bill 2017 (HR 1)</th>
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<tbody>
<tr>
<td><strong>Corporate income</strong></td>
<td>35% top rate</td>
<td>20% flat rate; 25% for personal services corporations; effective for tax years after 12/31/17</td>
<td>20% flat rate; effective for tax years after 12/31/18</td>
</tr>
<tr>
<td><strong>Corporate AMT</strong></td>
<td>20% on alternative minimum taxable income</td>
<td>Repealed</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Manufacturing deduction (§199)</strong></td>
<td>9% deduction on lesser of qualified production activity income or taxable income</td>
<td>Repealed</td>
<td>Repealed for tax years after 12/31/18</td>
</tr>
<tr>
<td><strong>Passthrough income</strong></td>
<td>Taxed at owner’s individual rate</td>
<td>25% rate on business profits, with assumed 70/30 split of wages to business profits - May elect to prove capital percentage &gt;30% - 0% capital percentage assumed for personal services businesses; may elect to prove a higher percentage - 9% rate for smaller firms that wouldn’t otherwise qualify for 25% rate</td>
<td>23% deduction for business profits through 2025, limited to 50% of W-2 wages - Personal services businesses not eligible, except for taxpayers with taxable income &lt;$250k/$500k - Taxpayers with taxable income &lt;$250k/$500k not subject to wage limitation</td>
</tr>
</tbody>
</table>

**Notes:** These are general summaries, and many of the provisions include exceptions and effective dates that should be read carefully. Unless otherwise stated, provisions are generally effective for tax years beginning after 12/31/17.
## Tax Cuts and Jobs Act (HR 1)
### Business taxation (cont.)

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<td><strong>Capital expensing</strong></td>
<td><em>MACRS/ADS with bonus depreciation; or accelerated use of AMT credits</em></td>
<td>100% immediate expensing through 2022</td>
<td>100% immediate expensing through 2022, then phased down each year through 2026 (2023 = 80%, 2024 = 60%, 2025 = 40%, 2026 = 20%)</td>
</tr>
<tr>
<td><strong>Business interest payments</strong></td>
<td><em>Generally deductible</em></td>
<td>Limited to business interest income + 30% of EBITDA</td>
<td>Limited to business interest income + 30% of EBIT</td>
</tr>
<tr>
<td></td>
<td>• 5-year carryforward for disallowed amounts</td>
<td></td>
<td>• Indefinite carryforward for disallowed amounts</td>
</tr>
<tr>
<td><strong>Net operating loss deduction</strong></td>
<td>2-year carryback and 20-year carryforward allowed to offset taxable income</td>
<td>NOL use limited to 90% of taxable income deductible; carryforward period made indefinite; NOLs increased by interest factor</td>
<td>Limited to 90% of taxable income deductible through 2022, then 80%; carryforward period made indefinite</td>
</tr>
<tr>
<td><strong>Like-kind exchanges</strong></td>
<td><em>No gain or loss recognized for wide range of property held for productive use or investment</em></td>
<td>Allowed only for real property</td>
<td></td>
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Information current as of 12/2/17
Some other provisions of note:

- Repeal deduction for local lobbying expenses (both)
- Repeal deduction for certain unused business credits (House); and for entertainment, amusement or recreation activities, facilities, or membership dues, transportation fringe benefits, athletic facilities, or personal amenities provided to employees (both)
- Denial of deduction for certain fines, penalties, and settlement costs (Senate)
- Repeal (House) or modify (Senate) credit for orphan drug testing, and rehabilitation credit
- Repeal credit for employer-provided child care, work opportunity credit, and new markets credit (House)
- Allow credit for paid family and medical leave (Senate)
- Prohibition on cash/cash-equivalent employee achievement awards (Senate)
- Repeal private activity bonds, tax credit bonds, and tax-exempt bonds for professional stadiums (House), and advance refunding bonds (both)
- Create qualified opportunity zones (Senate)
- Modify energy production and investment credits (House)
- Modify rules for tax treatment of alcoholic beverages (Senate)
- Wide ranging proposals affecting life insurers (Senate); 8% life insurance profits surtax (House)
- Require certain R&D expenditures to be amortized over 5 years if done in US; 15 if done abroad (both; delayed effective date in Senate)
- Reduce depreciation life of buildings (Senate)
- Stronger limits on deduction for executive compensation >$1 million (both)
## Tax Cuts and Jobs Act (HR 1)
### International taxation

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<td><strong>International taxation</strong></td>
<td>Worldwide regime with deferral and foreign tax credit offsets</td>
<td>Deemed repatriation of previously untaxed E&amp;P at rate of 7% (non-cash) or 14% (cash &amp; equivalents) • Applied to E&amp;P as of 11/2/17 or 12/31/17, whichever is higher</td>
<td>Deemed repatriation of previously untaxed E&amp;P at rate of 7.49% (non-cash) or 14.49% (cash &amp; equivalents) • Claw-back of rate reduction if company inverts within 10 years after bill enactment</td>
</tr>
<tr>
<td><strong>Foreign-held earnings &amp; profits</strong></td>
<td>US tax deferred until repatriated</td>
<td></td>
<td></td>
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## Tax Cuts and Jobs Act (HR 1)
### International taxation (cont.)

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<th><strong>“Base-erosion prevention” measures</strong></th>
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<td><strong>Subpart F rules for passive income</strong></td>
<td><strong>20% tax on 50% of foreign high return amounts</strong></td>
<td>20% tax on “global intangible low-taxed income” (GILTI) with 50% deduction for foreign-derived intangible income (FDII) through 2025, then 37.5%; and 20% tax on FDII with 37.5% deduction through 2025, then 21.875% • Opens path to tax-free repatriation of IP</td>
<td></td>
</tr>
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**Additional limits on deductions by US corporations of interest paid on related-party debt**

- **Tax of up to 20% on payments made to related parties abroad from US operations unless treated as “effectively connected income” (ECI)**
- **10% “minimum tax” on taxable income in excess of deductible payments to related foreign parties**
- **Deduction denied for interest or royalties paid abroad if no corresponding inclusion to related party or if related party is allowed deduction**
### Tax Cuts and Jobs Act (HR 1)
#### Individual taxation

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<td><strong>Individual income</strong></td>
<td>7 brackets Top rate of 39.6% on income &gt;$418.4k/$470.7k (single/joint); Plus 0.9% Medicare tax on income &gt;$200k/$250k</td>
<td>4 brackets Top rate of 39.6% on income &gt;$500k/$1M Plus 6% bubble tax on income $1M-$1.2M Plus 0.9% Medicare tax on income &gt;$200k/$250k</td>
<td>7 brackets Top rate of 38.5% on income &gt;$500k/$1M Changes sunset 12/31/25 Plus 0.9% Medicare tax on income &gt;$200k/$250k</td>
</tr>
<tr>
<td><strong>Standard deduction</strong></td>
<td>$6,350/$12,700</td>
<td>$12k/$24k</td>
<td>$12k/$24k Sunsets 12/31/25</td>
</tr>
<tr>
<td><strong>Personal exemption</strong></td>
<td>$4,050 exemption for each member of household, phased out for higher AGIs</td>
<td>Repealed</td>
<td>Repealed through 12/31/25</td>
</tr>
<tr>
<td><strong>AMT</strong></td>
<td>26%/28% on alternative minimum taxable income</td>
<td>Repealed • 50% of AMT credit carryforwards refundable in 2019-2021; remaining credits refundable from 2022</td>
<td>Exemption increased through 12/31/25</td>
</tr>
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*Information current as of 12/2/17*
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<td><strong>Estate tax, generation-skipping tax, and gift tax</strong></td>
<td>40% top estate, gift, and GST tax rate; exemption $5M/$10M, adjusted annually for inflation ($5.6M/$11.2M in 2018)</td>
<td>40% estate and generation-skipping tax through 2023; both repealed in 2024; gift tax lowered to 35%; exemption for all increased to $10M/$20M</td>
<td>40% after exemption of $10M/$20M; increased exemption sunsets 12/31/25</td>
</tr>
<tr>
<td><strong>State and local tax (SALT) deduction</strong></td>
<td>State and local income and property taxes or sales taxes fully deductible</td>
<td>Property taxes up to $10k deductible; other SALT generally non-deductible</td>
<td>Same, through 12/31/25</td>
</tr>
<tr>
<td><strong>Mortgage interest deduction</strong></td>
<td>Deduction on first $1M of debt used to secure primary or secondary residence, or first $100k of home equity debt</td>
<td>Interest deductible on first $500k of debt for primary residence only</td>
<td>Home equity debt deduction repealed through 12/31/25</td>
</tr>
<tr>
<td><strong>Exclusion of gain from sale of principal residence</strong></td>
<td>Up to $250k/$500k of gain on sale excluded from gross income; must have been principal residence 2 of past 5 years; allowed once every 2 years</td>
<td>Residency required 5 of past 8 years; exclusion allowed once every 5 years</td>
<td>Residency required 5 of past 8 years; exclusion allowed once every 5 years; changes sunset 12/31/25</td>
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Information current as of 12/2/17
Tax Reform Observations and Timing
Tax reform observations

- Budget reconciliation provides the means to pass tax reform with a simple majority but comes with significant limitations.
- Budget resolution provides for $1.5 Trillion in un-offset tax cuts in the first ten years, however, reconciliation instructions prohibit increasing the deficit over the long-run.
- The Senate republican version of tax reform has significant differences when compared to the House GOP approach.
- The task of navigating a path to passing tax reform with the minimum approval of 218 representatives, 50 senators, and one president, all with their own competing interests and outside influences, is now just beginning.
Getting to 50 votes in the Senate
The potential holdouts

Deficit concerns
- Lankford (OK)

Retiring/“Voting my conscience”
- Flake (AZ)
- Corker (TN)

ACA heartburn
- Collins (ME)

Pending health issues
- McCain (AZ)
- Cochran (MS)

Passthrough concerns
- Daines (MT)
- Johnson (WI)
Do Congressional republicans need a “win” on tax reform?
Democratic challengers out in force early for 2018

Number of House incumbents with challengers as of Sept. 30 of non-election year

Note: Each district is counted only once, with the best-funded challenger counted. The average cost of winning a House seat in 2016 was $1.5 million.
Source: Campaign Finance Institute
Executing the “hard pivot” to tax reform
December 8 cliff / encroaching mid-terms = brief window for action

**115th Congress**

Congress Reconvenes  
IRS Comm’r Koskinen’s Term Ends  
Med Device Tax Moratorium Expires  
First Congressional Primary  
FY2018 Ends  
Mid-Term Elections

**August Recess**

**December 22**

- Current “Continuing Resolution” Expires  
  (defense and nondefense appropriations lapse)
- Debt Limit Suspension Period Ends  
  ("extraordinary measures" to delay hard deadline to March-April 2018, per CBO)

**(Hoped-For) Tax Reform Timeline**

- **Week of November 6**  
  House Ways and Means Committee markup / Senate GOP bill released  
  Completed

- **Week of November 13**  
  House floor consideration & passage / Senate Finance Committee markup  
  Completed

- **Week of November 27**  
  Senate floor consideration & passage  
  Completed

- **Remainder of 2017**  
  Conference committee and final passage / enactment
Once in a Generation?
Major Tax Laws Enacted since 1986

1986
1987 Omnibus Budget Reconciliation Act
1988 Technical & Miscellaneous Revenue Act
1989 Omnibus Budget Reconciliation Act
1990 Omnibus Budget Reconciliation Act
1991 Tax Extension Act
1993 Omnibus Budget Reconciliation Act
1994 Omnibus Budget Reconciliation Act
1995 Omnibus Budget Reconciliation Act
1996 Small Business Job Protection Act
1997 Taxpayer Relief Act
1998 Internal Revenue Service Restructuring Act
1999 Jobs & Growth Tax Relief Reconciliation Act
2000 Economic Growth & Tax Relief Reconciliation Act
2001 Economic Growth & Tax Relief Reconciliation Act
2002 Job Creation & Worker Assistance Act
2003 Jobs & Growth Tax Relief Reconciliation Act
2004 Patient Protection & Affordable Care Act
2005 Tax Increase Prevention & Reconciliation Act
2006 Tax Relief & Health Care Act
2007 Pension Protection Act
2008 Economic Stimulus Act
2009 American Recovery & Reinvestment Tax Act
2010 Patient Protection & Affordable Care Act
2011 Tax Relief, Unemployment Insurance Reauthorization & Job Creation Act
2012 American Taxpayer Relief Act

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