Tax Insights
from Washington National Tax Services

Conference Committee Agreement Reached on Final Tax Reform Bill

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In brief

A House and Senate conference committee on December 15 reached agreement on a final version of tax reform legislation, the 'Tax Cuts and Jobs Act,' that would lower business and individual tax rates, modernize US international tax rules, and provide the most significant overhaul of the US tax code in more than 30 years.

The House and Senate conference committee agreement (the 'Conference Agreement' or the 'Agreement') features a number of notable changes to the House and Senate tax reform bills, including a decision to lower permanently the US federal corporate income tax rate from 35 percent to 21 percent, instead of the 20-percent corporate rate that had been approved previously by each chamber. The Conference Agreement also would reduce the current 39.6-percent top individual income tax rate to 37 percent, lower than the top individual rates that had been approved separately by the House and Senate. Both the new corporate tax rate and revised individual tax rates would be effective for tax years beginning after December 31, 2017. The Agreement would repeal the corporate alternative minimum tax (AMT), while retaining a modified individual AMT with higher exemption amounts and phase-out thresholds.

The Conference Agreement would provide a revised 20-percent deduction for certain pass-through business income, and new rates for a repatriation 'toll tax' (15.5 percent for cash and cash equivalents and eight percent for illiquid assets) that are higher than the earlier House or Senate versions. The Agreement makes numerous additional revisions to House and Senate tax reform proposals affecting businesses, international tax rules, and individuals. The Agreement also modifies or drops various revenue-raising provisions that had been proposed in the House or Senate bills to offset part of the cost of the proposed tax reforms.

The House and Senate are expected to vote early next week on the final Conference Agreement. Congressional Republican leaders are confident that they have the votes needed to pass the tax reform legislation so that it can be signed into law by President Trump before the end of the year.

In detail

Below is a summary of key provisions of the final Conference Agreement to resolve differences between the tax reform bills passed recently by the House and Senate. A separate, more detailed overview summary of the Conference Agreement will be issued in coming days.

The Conference Agreement is estimated to increase the on-budget deficit by $1.482 trillion over 10 years, which is in line with FY 2018 budget reconciliation instructions that limit the overall revenue cost of the legislation to $1.5 trillion over 10 years. While the corporate rate reduction and international reforms are proposed to be permanent, the Agreement sunsets nearly all individual tax provisions (including the pass-through deduction) at the end of 2025 in order to comply with Senate budget reconciliation rules, as discussed below.

The legislation is proposed generally to be effective for tax years beginning after 2017. Certain provisions have separate effective dates, while others are effective after the date of enactment and some are effective for tax years beginning after 2016. The bill also proposes some temporary measures and provides transition rules for certain proposals.

Observation: ASC 740, Accounting for Income Taxes, requires the effects of changes in tax laws or rates to be recognized in the period in which the law is enacted regardless of the effective date. For US federal tax purposes, the enactment date is most often the date the President signs the bill into law.

Corporate rate reduction

Under the final Conference Agreement, the current 35-percent top corporate rate would be reduced permanently to 21 percent for tax years beginning after 2017. Both the House and Senate had previously approved reducing the US corporate rate to 20 percent, but the Senate bill would have delayed the corporate rate reduction by one year later than the House version, to tax years beginning after 2018.

Observation: Lowering the US corporate tax rate from 35 percent to 21 percent will be an historic achievement since the United States currently has the highest statutory corporate tax rate among advanced economies. The US corporate tax rate, combined with average state and local corporate rates, currently is 38.9 percent. The combined US corporate rate will drop to 25.75 percent as a result of the Tax Cuts and Jobs Act. This rate will still be two percentage points higher than the 23.75 percent average rate for all other OECD nations in 2017, but would be lower than all other G-7 countries except the United Kingdom.

Pass-through tax provisions

The Conference Agreement generally adopts the Senate bill's approach to providing reduced taxes on certain domestic qualified business income of an individual. The Agreement would provide a 20-percent deduction for qualified business income from a partnership, S corporation, or sole proprietorship (down from 23 percent in the Senate bill), but would achieve the same level of effective tax rate relief since the 20-percent deduction combined with a top ordinary income tax rate of 37 percent would result in a top rate of 29.6 percent for such income in the absence of other limitations.

The Conference Agreement modifies the W-2 wage limitation, which applies to qualified business income other than qualified REIT dividends, cooperative dividends, and publicly traded partnership income of individuals above the relevant income thresholds noted below. Under the Agreement, the deduction for qualified business income subject to the wage limitation is capped at the greater of (a) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property. The Agreement lowers the income threshold at which the W-2 wage limitations and specified service business exclusions would apply, to $157,500 for a single filer and $315,000 for a joint filer, down from $250,000 and $500,000 respectively in the Senate bill. In addition, the Agreement removes engineering and architecture services from the list of excluded specified service businesses. The Agreement also provides that trusts and estates are eligible for the 20-percent deduction.

The Agreement retains a Senate proposal to disallow the deduction by noncorporate taxpayers of excess business losses (i.e., business losses in excess of business income plus $500,000 for joint filers and $250,000 for all others).

International proposals

The Conference Agreement generally would follow the Senate bill's approach, with some modifications, to implementing a territorial tax system by providing a 100-percent dividends received deduction (DRD) for certain qualified foreign-source dividends received by US corporations from foreign subsidiaries, effective for tax years of foreign corporations beginning after 2017. The Agreement also generally adopts the Senate deduction for 'foreign derived intangible income' (FDII), the global intangible low-taxed income' (GILTI) provisions, as well as the 'base erosion and anti avoidance tax' (BEAT) provisions, with certain modifications. However, the Agreement drops a Senate proposal to provide for the nontaxable transfer of intangible property from controlled foreign corporations (CFCs) to US shareholders.

As noted above, the Conference Agreement increases the tax rates for the mandatory repatriation toll tax to 15.5 percent for cash or cash-equivalents and eight percent for illiquid assets. These rates are higher respectively than the 14 percent and 7 percent rates proposed in the House bill, and the 14.49 percent and 7.49 percent rates proposed in the Senate bill.

The Agreement drops certain other international provisions from the final legislation, including a proposal to make permanent the CFC 'look-through' rule, and a proposal to accelerate the effective date of the worldwide interest allocation rules.

Cost recovery

The Conference Agreement would allow businesses to write off (or 'expense') immediately the cost of qualified property (not including structures) acquired and placed in service after September 27, 2017 and before January 1, 2023 (January 1, 2024 for longer production period property and aircraft). The Agreement retains language from the Senate bill that would phase-down full expensing by 20 percent a year in the case of property placed in service after December 31, 2022 and before January 1, 2027 (after December 31, 2023 and before January 1, 2028 for longer production period property and aircraft). The Agreement adopts language from the House Bill that would extend the additional first-year depreciation deduction to used property.

The Agreement adopts the Senate version of a proposal to require the amortization of research expenditures, but would make the provision effective for amounts paid or incurred in tax years beginning after 2021, instead of tax years beginning after 2025.

The Agreement would increase Section 179 'small business expensing' to $1 million, with a phaseout range beginning at $2.5 million and an expanded definition of qualifying property.

Interest expense

The Conference Agreement generally follows the Senate bill's approach to limiting the deduction for business interest to the sum of business interest income plus 30 percent of the 'adjusted taxable income' of the taxpayer for the taxable year and allowing unused deductions to be carried forward indefinitely. However, for tax years beginning after December 31, 2017 and before January 1, 2022, the Agreement would 'add back' depreciation and amortization. The Agreement also follows the House bill in exempting from the limitation taxpayers with average gross receipts for the three-taxable-year period ending with the prior taxable year that do not exceed $25 million.

The Agreement drops a separate proposal (versions of which were in both the House and Senate bills) to impose a new Section 163(n) provision that would have denied a deduction for certain interest expense of US shareholders that are members of worldwide affiliated groups with 'excess' domestic indebtedness.

Other business proposals

The Agreement would limit net operating loss (NOL) deductions to 80 percent of taxable income for losses arising in tax years beginning after 2017. This provision generally follows the Senate bill allowing NOLs to be carried forward, not backward, except that the Senate bill proposed that the initial NOL deduction limit would have been set at 90 percent, and the 80 percent limitation would not have applied until after 2022.

Like the House and Senate bills, the Conference Agreement would retain the research credit (with conforming modifications after 2021 for capitalization and amortization of research expenditures, as noted above) and the low-income housing tax credit. The Agreement would repeal the Section 199 domestic manufacturing deduction and certain other business tax credits. The Agreement drops House proposals to repeal the Work Opportunity Tax Credit and New Markets Tax Credits.

The Agreement drops House proposals to accelerate the phaseout of certain renewable energy tax credit provisions and repeal the credit for plug-in electric drive motor vehicles.

The Agreement would repeal like-kind exchange gain deferral rules, except for real property.

The Agreement reduces the 'orphan drug' tax credit to 25 percent, similar to the reduction to 27.5 percent in the Senate bill, instead of repealing it as proposed by the House bill. The Agreement also drops a House proposal to repeal Section 1235 rules treating the gain or loss from a sale or exchange of patents as a capital asset.

The Agreement would limit deductions for Federal Deposit Insurance Corporation (FDIC) premiums. The Agreement also retains modified versions of several proposals affecting the tax treatment of insurance, including proposals dealing with the computation of life insurance reserves, the capitalization of certain policy acquisition expenses, and property and casualty company discounting rules. The Agreement drops a House proposal to impose an eight-percent surtax on life insurance company taxable income that had been inserted as a placeholder.

The Agreement would impose a three-year holding period requirement for qualification as long-term capital gain with respect to certain partnership interests (or 'carried' interest) received in connection with the performance of services.

The Agreement also would repeal certain exceptions to the current $1 million limit on excessive employee remuneration, and modify the definition of covered employees. In addition, an excise tax would be imposed on certain ‘excess’ compensation received by tax-exempt organization executives.

Additional business tax provisions in the Conference Agreement include proposals to deny deductions for certain entertainment expenses and repeal of the exclusion for employee achievement awards.

The Agreement adopts a Senate proposal to provide a temporary employer credit for paid family and medical leave.

Individual provisions

Like the Senate bill, the Conference Agreement would retain the current bracket structure of seven individual tax rates, but would lower the top rate to 37 percent and make additional modifications to tax rates and income levels for some brackets. The Agreement also would adjust individual tax brackets and other individual provisions for inflation based on chained CPI (the chained CPI adjustment is not subject to sunset). The Agreement would nearly double the individual standard deduction while eliminating or reducing many individual tax deductions and exclusions.

The Conference Agreement would permit individual taxpayers to deduct up to $10,000 for any combination of state and local income taxes, property taxes, or sales taxes. Like both the House and Senate bills, the Agreement would eliminate the ‘Pease’ limitation on individual itemized deductions.

The Conference Agreement retains the mortgage interest deduction for existing mortgages and limits the deduction to interest on mortgages up to $750,000, effective for new mortgage debt incurred after December 31, 2017 and subject to a binding contract exception. The deduction is available for mortgages on a first or second home. The Agreement would eliminate the deduction for interest on home equity loans. The Agreement does not change the current rules for excluding the gain from sale of a principal residence.

The Agreement drops a Senate proposal to require recognition of gain for sale of securities on a first-in, first-out (FIFO) basis.

The Agreement preserves the itemized deduction for charitable contributions, with certain modifications that include denying deductions for college athletic event seating rights.

The Conference Agreement modifies the expanded $2,000 child tax credit in the Senate bill by increasing to $1,400 the refundable portion of the credit. At the same time, the Agreement drops a proposal to increase the age limit for a qualifying child from 17 to 18 years old. The Agreement would provide a $500 nonrefundable credit for qualifying dependents other than a qualifying child. The Agreement also lowers the phaseout threshold gross income levels for claiming the credit, to $400,000 for joint filers and $200,000 for all other filers, down from $500,000 for all filers under the Senate bill.

The Agreement modifies Section 529 education savings plan rules to allow distributions of up to $10,000 annually for tuition expenses incurred in connection with enrollment or attendance of a student at a public, private or religious elementary or secondary school. The Agreement also modifies the definition of qualifying education expenses to include certain homeschooling expenses.

Current Law (2018)			Conference Agreement		
Rate	Taxable income		Rate	Taxable income	
	Single	Married		Single	Married
10%	$0 to $9,525	$0 to $19,050	10%	$0 to $9,525	$0 to $19,050
15%	$9,526 to $38,700	$19,051 to $77,400	12%	$9,526 to $38,700	$19,051 to $77,400
25%	$38,701 to $93,700	$77,401 to $156,150	22%	$38,701 to $82,500	$77,401 to $165,000
28%	$93,701 to $195,450	$156,151 to $237,950	24%	$82,501 to $157,500	$165,001 to $315,000
33%	$195,451 to $424,950	$237,951 to $424,950	32%	$157,501 to $200,000	$315,001 to $400,000
35%	$424,951 to 426,700	$424,951—$480,050	35%	$200,001 to $500,000	$400,001 to $600,000
39.6%	$426,701 or more	$480,051 or more	37%	Over $500,000	Over $600,000

The Agreement drops certain House proposals affecting higher education, including proposals to Consolidate the American Opportunity Tax Credit, the Hope Scholarship Credit, and the Lifetime Learning Credit into the American Opportunity Tax Credit, repeal the exclusion for qualified tuition reductions, and repeal the deduction for qualified tuition and related expenses. The Agreement drops a House proposal to repeal the individual deduction for unreimbursed medical expenses that exceed 10 percent of adjusted gross income, and instead adopts a Senate proposal to reduce temporarily the threshold for deducting such expenses to 7.5 percent, effective for tax years after 2016 and before 2019. The Agreement also drops a House proposal to repeal a credit for the elderly and permanently disabled.

The Conference Agreement follows the Senate bill in doubling the estate tax exemption amounts through 2025. The Agreement does not include a House proposal to repeal the estate tax after 2024.

Individual tax relief sunsets

Like the Senate bill, the Conference Agreement would sunset nearly all individual provisions (including pass-through business tax relief provisions) after 2025, in order to comply with a Senate budget reconciliation rule that allows a 60-vote procedural point of order against any legislation increasing federal deficits in future decades. The Conference Agreement would make permanent the proposed corporate and international reforms.

Alternative minimum tax

The Conference Agreement repeals the corporate alternative minimum tax (AMT) and provides a mechanism for prior year corporate AMT credits to be refunded by the end of 2021. The individual AMT is retained, with increased exemption amounts and phase-out thresholds. Under the Agreement, the AMT exemption amount is increased to $109,400 for joint filers and $70,300 for all other taxpayers (other than estates and trusts). The phase-out thresholds are increased to $1 million for joint filers and $500,000 for all other taxpayers (other than estates and trusts).

Other provisions

The Conference Agreement drops a House proposal to repeal the tax-exempt interest exclusion for qualified private activity bonds. The Agreement does retain a provision in the House and Senate bills to repeal the tax-exempt interest exclusion for advance refunding bonds. The Agreement also includes other provisions affecting tax-exempt bonds.

The agreement drops a House proposal to reduce the minimum age for in-service distributions for defined benefit plans and state and local government defined contribution plans.

The Agreement adopts a Senate provision related to separately computing unrelated business tax income (UBTI) for each trade or business activity. The Agreement does not include a House proposal to clarify UBTI rules for certain tax-exempt organizations and to modify UBTI rules for research income.

The Agreement retains a modified version of the Senate proposal to impose an excise tax on the endowment investment income of certain private colleges and universities.

The Conference Agreement adopts a provision from the Senate bill that would effectively repeal the Affordable Care Act (ACA) individual mandate by reducing the ACA individual shared responsibility payment to zero. The Agreement also adopts the Senate proposal to allow oil and gas exploration in the Arctic National Wildlife Refuge (ANWR).

Next steps

Both the House and Senate must vote to pass the final conference committee agreement in identical form before tax reform legislation can be signed into law by President Trump. Assuming House and Senate passage, President Trump currently is expected to sign the 'Tax Cuts and Jobs Act' before the end of this year.

The takeaway

Congress is on track to approve historic tax reform in coming days. The effort to enact a reform of US tax law providing a more competitive tax system for business taxpayers and improved economic opportunities for individuals and families is now close to completion.

Stakeholders should remain engaged in the tax reform process as Congress votes on the legislation and then the Treasury Department and Internal Revenue Service begin the regulatory process to implement the legislation.

For more information on the Conference Agreement

- Conference Committee report with statutory text (1,101 pages)
- Conference Committee explanation (570 pages)
- JCT staff revenue score (10 pages)
- Conference Committee policy highlights (2 pages)

Of further interest

- Visit our Policy on the move website to understand how policy change could impact your business.
- Get your free trial of Inside Tax Policy, our on-demand video platform to keep up with policy changes as they unfold.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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