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Dear Friends,

As many of you know the Congress is set to pass the Tax Cuts & Jobs Act (the "Act"). FGMC has been tracking this legislation and previously released our analysis of some key provisions of the original House of Representatives and Senate versions of this legislation. Both the House and Senate have now come together on the resulting legislation, and it is expected to pass both houses and obtain the President's signature this week.

The bill itself, along with the explanatory statement prepared by the conference committee exceeds 1,000 pages. In other words, we are still digesting much of this information that was only released to the public on Friday, and we will likely will continue to analyze this piece of legislation in the coming weeks. We anticipate providing more detailed analyses of certain aspects of the Tax Cuts & Jobs Act in the future.

Many changes in the law that are applicable to individual taxpayers expire for tax years after December 31, 2025. Most changes to corporate tax laws do not expire. In general, we have tried to provide you with both the effective date of most changes in the law (generally, tax years after December 31, 2017) and the expiration date of these changes, after which we will revert back to tax laws that exist today (at least, before enactment of the Act).

This analysis is only intended as a summary of those provisions likely to affect most of our clients. It is not intended to be a comprehensive review of the entire piece of legislation. If we've missed an aspect of the tax plan you would like more information about, please feel free to contact me and we'll do our best to respond to as many inquiries as we can. Our summary is lengthy, but I encourage you to at least scan the headings of each section. I'm sure you will find some aspects of the Act you will be interested in.

As in our prior letters we have not endeavored to quantify how much certain classes of Americans will save under the Act (e.g., a family of four earning *x* amount of dollars) since this requires consideration of a myriad of assumptions and cases.

Feel free to contact me with any questions, or if you would like my take on any of the inevitable political spin either in favor or against this legislation.

Sincerely,

Steven M. Weiser, Esq.

Individual Income Taxes

Income Tax Brackets

Background/The Act: The Act reduces the number of tax brackets and enlarges the income thresholds at which each higher bracket is reached. Below is a comparison of existing brackets and the new brackets for single and married filing jointly filers. Note, that when reviewing brackets they should be interpreted as for example, "over $9,525 but not over $38,700." Also, brackets are progressive, so that even high earning individuals may take advantage of the lower rates on those portions of their incomes fitting into the lower tax brackets, though top earners actually reach a point where the 39.6% bracket actually phases out the benefit of the 12% rate.

Existing Rates		**The Act**	
Unmarried Individuals		**Unmarried Individuals**	
Taxable Income	Tax Rate	Taxable Income	Tax Rate
Under $9,525	10%	Under $9,525	10%
$9,525 to $38,700	15%	$9,525 to $38,700	12%
$38,700 to $93,700	25%	$38,700 to $82,500	22%
$93,700 to $195,450	28%	$82,500 to 157,500	24%
$195,450 to $424,950	33%	$157,500 to $200,000	32%
$424,950 to $426,700	35%	$200,000 to $500,000	35%
Over $426,700	39.6%	Over $500,000	37%
Married Filing Jointly & Surviving Spouse		**Married Filing Jointly & Surviving Spouse**	
Taxable Income		Taxable Income	
Under $19,050	10%	Under $19,050	10%
$19,050 to $77,400	15%	$19,050 to $77,400	12%
$77,400 to $156,150	25%	$77,400 to $165,000	22%
$156,150 to $237,950	28%	$165,000 to $315,000	24%
$237,950 to $424,950	33%	$315,000 to $400,000	32%
$424,950 to $480,050	35%	$400,000 to $600,000	35%
Over $480,050	39.6%	Over $600,000	37%

Comments: Just considering this change in the law alone, a married couple with an annual adjusted gross income of $75,000 would save $ 1,698.50. A married couple earning $250,000 would save $9,138, and a couple earning $1 million would save $31,851.80. The

adjusted rate structure is effective for 2018, but does not apply for tax years beginning after December 31, 2025.

Individual Standard Deduction

Background/The Act: The Act increases the standard deduction for taxpayers. The following is a comparison of the standard deductions for those filing as unmarried persons, married filing jointly or surviving spouse, and head of household for 2017 as compared to the Act:

Existing Standard Deduction		Proposed Standard Deduction	
Single	$6,350	Single	$12,000
Married Filing Jointly & Surviving Spouse	$12,700	Married Filing Jointly & Surviving Spouse	$24,000
Head of Household	$9,350	Head of Household	$18,000

Comments: For some lower earning Americans or those who do not itemize deductions the increased standard deduction provides a tax savings by way of the increased tax deduction. The House GOP represents that the increased standard deduction simplifies tax compliance by eliminating the need for many Americans to itemize (however, one would think many Americans would still go through the process of evaluating each year whether the standard deduction or itemizing deductions is more advantageous). The increased standard deduction is not applicable for tax years after December 31, 2025.

Personal Exemptions

Background/The Act: A personal exemption deduction is allowed for taxpayers and their qualifying dependents. The amount of the deduction in 2018 is $4,150 for each such person (e.g, a married couple with two young dependents will have a $16,600 deduction). The exemption is phased out at high income levels (beginning at $320,000 for married persons filing jointly and $266,700 for single individuals). The Act eliminates the personal exemption deduction entirely.

Comments: This proposal would seem to offset much of the benefit of an increased standard deduction for many Americans. For example, a young family of four that does not itemize exemptions has the additional standard deduction of $11,000 (when compared to existing law) offset entirely by the loss of the personal exemption and dependent deduction which is worth

$16,600 in 2018. The personal exemption will be reinstated for tax years beginning after December 31, 2025.

Currently employees complete a Form W-4 by which they can claim an appropriate number of exemptions (personal and dependent). This affects the amount of tax withheld as salary is paid. The Act directs the Secretary of the Treasury to develop new rules to determine how taxes will be withheld from employee salaries.

Elimination of the Individual Mandate for Health Insurance

Background/The Act: The Patient Protection and Affordable Care Act required individuals to obtain health insurance providing required minimum amounts of coverage. Failure to maintain such coverage resulted in an individual owing a tax (known as the "individual mandate"). The Act effectively eliminates the individual mandate effective for months beginning after December 31, 2018.

Comments: The Congressional Budget Office has warned that the elimination of the individual mandate could cause health insurance premiums to spike.

Deduction for Taxes Not Paid or Accrued In A Trade or Business

Background/The Act: In general, the Act provides that in the case of individual taxpayers deductions for state, local, and foreign property taxes, as well as state and local sales taxes are allowed only when paid or accrued in the conduct of a trade or business, or in an activity described in IRC § 212 (relating to expenses for the production of income). State and local income taxes are also not allowed as a deduction. An exception exists that allows individual taxpayers to claim an itemized deduction of up to $10,000 ($5,000 for married persons filing separate returns) for the aggregate of state and local property taxes not paid or accrued in connection with a trade or business (or activity described in IRC § 212), and state and local income taxes.

These rules apply for tax years beginning after December 31, 2017 and beginning before January 1, 2026.

Comments: Arguably, taxpayers residing in high tax states will be burdened by this provision more than other taxpayers, because state and local tax liabilities often exceed the $10,000 threshold.

Mortgage Interest Deduction

Background/The Act: The deduction for home mortgage interest is retained; however, the deduction is only allowed with respect to interest paid on up to $750,000 of acquisition indebtedness (half that for married taxpayers filing separately) for tax years beginning after December 31, 2017 and before January 1, 2016, down from the current threshold of $1 million. However, in the case of acquisition indebtedness incurred before December 15, 2017 the limitation is $1 million (half that for married taxpayers filing separately). For tax years after December 31, 2025 the limitation goes back to $1 million.

The Act also suspends the deduction for home equity indebtedness for tax years beginning after December 31, 2017 until tax years beginning after December 31, 2025.

Comments: The residential real estate industry and homeowners in areas where property values are highest aren't happy with this change, but it isn't as bad (to them) as the initial House bill. The mortgage interest deduction has long been considered significant in making home ownership affordance for many Americans, and reducing this deduction may cause outrage among those who believe it might adversely impact the residential real estate market.

Elimination of Certain Itemized Deductions

Background/The Act: The Act eliminates all miscellaneous itemized deductions that were subject to a floor of 2% of adjusted gross income. These deductions include, but are not limited to, expenses incurred for the production or collection of income (e.g., investment fees and expenses), tax preparation expenses, and unreimbursed employee business expenses.

Comments: This provision is effective for tax years beginning after December 31, 2017 and is not effective for tax years beginning after December 31, 2025.

Deduction for Alimony or Separate Maintenance

Background/The Act: Currently, a taxpayer is entitled to deduct the amount of alimony or separate maintenance they are required to pay to their ex-spouse. The Act eliminates this deduction, *and also* eliminates the requirement that the ex-spouse recognize these payments as taxable income.

Comments: This provision is effective for any divorce or separation agreement executed after December 31, 2018, or for any agreement executed before that date, but modified after December 31, 2018 if the modification specifically makes reference to this change in law.

Deduction for Charitable Contributions

Background/The Act: The Act increases the limitation on cash contributions to public charities from 50% to 60% of a taxpayer's adjusted gross income (AGI). It denies a charitable deduction for payments to higher educational institutions in exchange for the right to purchase tickets or seats at athletic events. In general, persons claiming charitable contribution deductions are required to maintain written records from the donee organization to substantiate the donation and deduction. An exception has been allowed where the done organization separately provides the information concerning the donation to the IRS. The Act eliminates that exception.

Comments: The changes to the contribution limitation and deduction for seating payments are effective for tax years beginning after December 31, 2017. The provision eliminating the exception contributions reported by donee organizations is effective for tax years beginning after December 31, 2016.

Limitation on Itemized Deductions

Background/The Act: Under current law the amount of most allowable itemized deductions is phased out when incomes reach certain thresholds. The Act repeals the overall limitation on itemized deductions. The repeal, however, is not effective for tax years after December 31, 2025.

Comments: Taxpayers with large incomes will certainly appreciate this modification of the law.

Child Tax Credit

Background/The Act: The Child Tax Credit allows for a credit of $1,000 for each dependent child of the taxpayer. The Act temporarily increases the child tax credit to $2,000 per qualifying child. The credit is also temporarily modified to allow for a $500 non-refundable credit for qualifying dependents other than children.

A maximum refundable credit of $1,400 per qualifying child is allowed. In order to receive the credit a taxpayer must include a social security number for each qualifying child for whom the credit is claimed. The credit cannot be claimed for a child age 17 or older, as is the case with current law.

Finally, the credit is phased out for taxpayers with adjusted gross incomes in excess of $200,000 or $400,000 for joint filers.

This provision expires for tax years beginning after December 31, 2025.

Comments: This change is intended to benefit low and middle income taxpayers the most. By raising the phase-out threshold significantly, more Americans will benefit.

Passive Loss Limitations – Taxpayers That are NOT Corporations

Background/The Act: Beginning after 2017, and before January 1, 2026, excess business losses of a taxpayer that is not a corporation are disallowed for a tax year, but may be carried forward (NOL carryovers). NOL carryovers may be deducted in a future year, but only to the extent of 80% of taxable income without regard to the deduction for NOLs. Unused NOLs can be carried forward indefinitely.

Farms may elect to carryback NOLs to two prior years.

529 Accounts

Background/The Act: The rules governing 529 Plans will be modified under the Act to allow for the distribution, on a tax-free basis, of up to $10,000 for elementary and secondary school tuition. The limitation applies on a per student basis, so although an individual may be the beneficiary of multiple 529 plan accounts the individual may receive a maximum of $10,000 free of tax. Currently, tax-free distributions are only allowed for qualifying higher education expenses (college level and above).

Comments: This is sure to be popular among Americans sending their children to private school. This proposal would allow parents to tap into funds already set aside, and increase opportunities to save for such tuition on a tax free basis. An additional benefit is a potential state income tax savings. For example, in Colorado contributions made to a CollegeInvest 529 account are deductible for state income tax purposes. By routing elementary and secondary school tuition payments through a 529 account, some of that tuition is effectively tax deductible for state income tax purposes. In Colorado this results in a savings of $463 each year if the full $10,000 is used. For families with multiple children the savings is multiplied accordingly as the $10,000 limitation appears to be a per-529 account limit, and not an overall family limitation. Of note is the fact that unlike the House version of the bill, unborn children cannot be appointed as a designated beneficiary of a 529 plan account.

Estate, Gift and Generation Skipping Transfer Taxes

Background/The Act: Current law allows for a unified credit for each individual that effectively exempts $5.49 million ($5.6 in 2018) of value in wealth transfers from any combination of estate and gift taxes. The current maximum rate of tax for both taxes is 40%. A similar exemption amount and tax rate exists for the generation skipping transfer tax. The Act increases the unified credit to $10 million per person (indexed for inflation) effective for gifts and the estates of decedents dying (as well as generation skipping transfers) after December 31, 2017, but before January 1, 2026.

Comments: Here we go again. Back in 2001 tax legislation called for a gradual increase in the unified credit, followed by an eventual repeal of the estate tax in 2010 (but only for that year), followed by a return to pre-2001 law. Now we are back on a roller-coaster that makes estate planning more complicated. I don't believe, should we ever actually return to the lower unified credit amount, that this will cause a claw-back in terms of lifetime gifts made using the increased unified credit (see this prior article), but in terms of planning for death we have to take into account the possibility at the time of death the available credit will be back to $5.6 million (adjusted for inflation of course).

Alternative Minimum Tax

Background/The Act: The alternative minimum tax (AMT) is imposed on an individual, estate, or trust to the extent it exceeds such taxpayers' regular tax liability. The Act increases the AMT exemption amount and the exemption amount phaseouts for the individual AMT. The

provision is applicable for tax years beginning after December 31, 2017 and before January 1, 2026.

A similar corporate AMT is repealed, effective for tax years beginning after December 31, 2017.

Comments: Proposals to completely repeal the AMT are often discussed because this tax, which was originally intended to impact a small number of taxpayers, seems to potentially impact more taxpayers each year. Legislation is periodically passed to limit the application of this tax, but has never repealed it, at least with respect to individual taxpayers.

Tax Reform Affecting Businesses

Corporate Income Tax Rate

Background/The Act: Corporate taxable income is currently subject to a four-step graduated rate structure. The top bracket of 35% applies for corporate taxable income in excess of $10 million. The Act eliminates the graduated rates and instead taxes corporate income at a single rate of 21%. The reduced rate is effective for tax years beginning after December 31, 2017.

Comments: Perhaps the cornerstone of this legislation and a change championed by President Trump during his presidential campaign, this may also be the bill's most controversial change. The 35% rate is among the highest corporate rates among developed countries, but the effective tax rate, calculated after taking into account available deductions, tax credits, etc. and as determined by the Congressional Budget Office is currently 18.6%, less than Japan and the U.K. and slightly higher than Germany (15.5%). Quantifying the effect of this change shouldn't be done without regard to other changes to tax laws impacting corporations.

This change does not impact S corporations, limited liability companies, partnerships, and other flow-through business entities.

Pass-Through Tax Treatment

Background/The Act: Pass-through business entities (S corporations, limited liability companies, partnerships, etc.) are generally not subject to income and capital gains taxes. Instead, the owners of such entities recognize and pay tax on their share of business income and capital gains at the ordinary income and capital gain rates otherwise applicable to such persons. To illustrate just how complicated this proposed law is, we'll describe this change in some detail.

For years beginning after 2017 individual taxpayers will generally be allowed to deduct 20% of "qualified business income" from partnerships, S corporations and sole proprietorships, as well as 20% of aggregate qualified REIT dividends, qualified cooperative dividends, and qualified publicly traded partnership income.

Qualified business income is the net amount of qualified items of domestic income, gain, deduction, and loss with respect to the qualified trade or business of a taxpayer. If the net amount of qualified business income is a loss it is carried forward to the next taxable year.

Items are considered qualified items of income, gain, deduction, and loss only to the extent they are effectively connected with the conduct of a trade or business in the U.S. (and generally Puerto Rico). Qualified items of income, gain, deduction, and loss do not include (1) any item taken into account in determining net long-term capital gain or net long-term capital loss; (2) dividends; (3) interest income other than that properly allocable to a trade or business; (4) gains from commodities transactions (other than those incurred in the normal course of business or with respect to inventory); (5) foreign currency gains (other than those directly related to the needs of a business activity); (6) net income from notional principal contracts, and (7) amounts received from an annuity not used in a trade or business.

Qualified business income does not include amounts paid by an S corporation that is treated as reasonable compensation of the taxpayer. Qualified business income does not include any guaranteed payment for services rendered with respect to the trade or business, and does not include amounts paid to a partner who is acting other than in his or her capacity as a partner for services.

A limitation on this deduction which is based upon W-2 wages paid by a business is phased in above a threshold amount of taxable income. A disallowance of the deduction for specified trades or businesses is also phased in above a threshold amount of taxable income.

A qualified trade or business is means any trade or business trade or business and other than the trade or business of being an employee. A specified service trade or business means any business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade where the principal asset of such business is the reputation or skill of one or more of its employees, or which involves a service of investing and investment management trading, or dealing in securities, partnership interests, or commodities. Specifically not included in the definition of specified service trade or businesses are engineering and architectural services, which were previously included in the Senate version of the Act.

The W-2 wage limitation effectively provides that a taxpayer's deduction under this provision is the lesser of 20% of qualified business income, or 50% of the W-2 wages with respect to the business. However, if the taxpayer's income is below a threshold amount ($157,500 in the case of single taxpayers, and $315,000 in the case of a joint filers) the deduction is equal to 20% of qualified business income. The W-2 wage limit is effectively phased in when income exceeds the threshold amounts, and is fully phased in when taxable income exceeds the threshold amount by $50,000 for single taxpayers and $100,000 for joint filers. Above the thresholds (but below being fully phased in) the wage limit is modified to be the greater of (a) 50% of the W-2 wages with respect to the trade or business, or the sum of 25% of the W-2 wages with respect to the trade or business and 2.5% of the unadjusted basis, immediately after acquisition, of all qualified property. Qualified property means tangible property of a character subject to depreciation that is held by and available for use by the qualified trade or business at the close of the tax year, and which is used in the trade or business and for which the depreciable period has not ended before the end of the tax year.

Though the deduction for income derived from specified service businesses is allowed, it is limited to the extent taxable income exceeds the above threshold amounts. The exclusion is fully phased in when taxable income exceeds the threshold amounts by $50,000 for single taxpayers and $100,000 for joint filers. Within the phase-in range the exclusion applies as follows: in computing the qualified business income with respect to a specified service trade or business, the taxpayer takes into account only the applicable percentage of qualified items of income, gain, deduction, or loss and of allocable W-2 wages. The applicable percentage is 100% reduced by the percentage equal to the ratio of excess taxable income over the threshold amount bears to $50,000 or $100,000 in the case of a joint return.

All the above rules are applied at the shareholder, partner or member level. Each taxpayer takes their allocable share of qualified items of income, gain, deduction or loss, including an allocable share of W-2 wages.

The deduction under this provision is not allowed in computing gross income. Rather, it is allowed as a reduction in taxable income. As a result, the deduction does not affect limitations based upon a taxpayer's adjusted gross income. The deduction is available to taxpayers that both itemize deductions, and do not itemize deductions.

This provision does not appear to expire after December 31, 2025.

Comments: This explanation of this very complicated provision of the law is taken largely from the official explanation accompanying the Act. Those hoping for tax simplification will be sorely disappointed. This doesn't come close. Expect this provision to be analyzed in greater detail in a future newsletter. I suspect big winners here to be investors in real estate.

Interestingly, the bill does nothing to repeal the carried interest rules that both Pres. Trump and Hillary Clinton claimed would be repealed if either were elected president.

<u>Increased Expensing – IRC § 179</u>

Background/The Act: Businesses will be able to fully and immediately deduct the cost of depreciable assets (as opposed to depreciating those costs over the assets' useful lives) with a maximum deduction of $1 million. The maximum deduction is phased out to the extent acquisitions exceeds $2.5 million. The current limitation is $500,000 (and phaseout is $2 million).

Comments: This popular expensing provision is designed to spur businesses towards increased capital investments.

<u>Deductible Interest</u>

Background/The Act: In general, businesses will only be able to deduct interest expense to the extent of 30% of adjusted taxable income, plus interest income. Businesses with gross receipts of $15 million or less are not subject to these rules. Disallowed interest can be carried forward indefinitely. For tax years beginning before January 1, 2022, adjusted taxable income is computed without regard to any deductions for depreciation, amortization or depletion, and without regard to IRC § 199 (income attributable to domestic production activities).

Comments: Under current law businesses may generally deduct all interest paid or accrued in a tax year. The inability to deduct all interest may impact how business choose to finance their operations (whether through debt or equity), and may make the analysis more difficult.

Net Operating Loss Deductions

Background/The Act: Under existing law a net operating loss (NOL) may be carried back two years and carried forward twenty. The Act limits a NOL deduction to 80% of taxable income (determined without regard to this deduction) for losses arising in tax years beginning after December 31, 2017. The existing carryback and forward rules are eliminated such that NOLs may be carried forward indefinitely. NOL carryforwards attributable to losses arising after December 31, 2017 are now increased annually to take into account the time value of money. A one year carryback is available with respect to certain disaster losses incurred in connection with a farming business or certain small businesses (average gross receipts over three years does not exceed $5 million). This provision is effective for tax years beginning after December 31, 2017.

Section 1031 Like Kind Exchanges

Background/The Act: Section 1031 of the Internal Revenue Code enables taxpayers to exchange property for other property of a "like-kind" without the recognition of taxable income. The Act would limit the applicability of Section 1031 to exchanges of real property that is not held primarily for sale. This provision is effective for exchanges occurring after December 31, 2017. However, an exception is provided if relinquished property is disposed of before December 31, 2017, or replacement property is received before this date.

Comments: Section 1031 is probably most often used in conjunction with the exchange of real property so this proposal may not change much for most taxpayers.

International Taxation

Participation Exemption for Foreign Income

Background/The Act: The bill creates a new participation exemption that effectively eliminates the tax on foreign source dividends paid by a "specified 10-percent owned foreign corporation" to its U.S. corporate shareholder(s), subject to a one-year holding period. No foreign tax credit or tax deduction is permitted with respect to a qualifying dividend. A specified 10-percent owned foreign corporation is any foreign corporation (other than a passive foreign investment company that is not also a controlled foreign corporation) with respect to which any domestic corporation is a US shareholder. Whether a domestic corporation is considered a US shareholder is determined under the rules applicable to controlled foreign corporations.

To transition to the territorial system of tax 10% or greater U.S. shareholders in foreign corporations would be required to include in income for the subsidiary's last tax year beginning before 2018 the shareholder's pro rata portion of post-1986 accumulated foreign earnings and profits held in cash or cash equivalents subject to a tax rate of 15.5%, and on post-1986 accumulated foreign earnings and profits held in illiquid assets subject to a tax rate of 8%. The U.S. shareholder could elect to pay such tax in eight installments.

Comments: Participation exemption systems have been used by other countries (the Netherlands is the first that comes to mind) for quite some time. Currently, the U.S. taxes its citizens, residents, and domestic business entities on their worldwide earnings, while much of the developed world has adopted a "territorial" system of taxation whereby each country taxes only the income derived from within its borders. The U.S. relies on tax treaties and a foreign tax credit to insure U.S. persons avoid the double taxation of income (in this case, taxing the same income more than once by multiple jurisdictions). For years many tax professionals and members of the business community have been urging the U.S. to move towards a system of territorial taxation. This proposal endeavors to do that.

During his campaign President Trump indicated a desire to change the tax laws so that U.S. corporations with large cash positions in foreign subsidiaries would repatriate some of those earnings. This proposal should make it easier for these U.S. based multinationals to bring that cash back home.

Indirect Foreign Tax Credits

Background/The Act: The indirect foreign tax credit is repealed under the bill with respect to taxes attributable to income qualifying for the participation exemption. The indirect foreign tax credit has been available to certain U.S. corporations that own stock in foreign corporations, and such stockholdings satisfy certain ownership criteria (generally with regard to the

percentage of the subsidiary owned). Upon repatriation of profits (the payment of dividends to the U.S. parent) the parent was able to claim a foreign tax credit attributable to foreign taxes paid by the foreign subsidiary on its earnings.

Comments: The participation exemption would seemingly make the indirect foreign tax credit unnecessary.

Changes to Subpart F

Background/The Act: Subpart F refers to that portion of the Internal Revenue Code containing a set of rules used to curb the deferral of U.S. income tax on certain forms of foreign income earned by foreign corporations controlled by U.S. shareholders. The Act makes several modifications to Subpart F including modifying the constructive ownership rules, eliminating the requirement that a CFC (controlled foreign corporation) must be controlled by U.S. persons for at least 30 days during a tax year, and expanding the definition of a US shareholder to include any US person who owns 10% or more of the total value of shares of all classes of stock of a foreign corporation.

Comments: Most Americans won't be impacted by these rules. The most significant change might be the elimination of the 30-day requirement, which could result in more taxpayers having to recognize and pay tax on foreign source income.

Prevention of Base Erosion

Background/The Act: Base erosion refers to the general strategy of exploiting differences in tax rules among countries to artificially shift profits to low-tax or no-tax jurisdictions. The Act takes several steps designed to curb the ability of taxpayers to avoid U.S. tax by artificially shifting income to other jurisdictions.

The legislation would subject US corporate shareholders of controlled foreign corporations to current taxation on 50% of global intangible low-taxed income (GILTI) with a deduction of 37.5% of foreign-derived intangible income. GILTI is the excess of a corporate shareholder's net CFC tested income, over the shareholder's net deemed tangible income return. Net CFC Tested income is the excess of tested income of each CFC over the pro rata tested loss of each CFC. The tested income of a CFC is the excess of gross income over deductions

properly allocated to such income, with certain exceptions. The tested loss is the excess of deductions properly allocable to gross income, with some exceptions, over such gross income. Net deemed tangible income return is equal to 10% of the aggregate of the shareholder's pro rata share of the qualified business asset investment (QBAI) of each CFC with respect to which it is a shareholder. QBAI is the average adjusted basis, determined at the close of each calendar quarter, of tangible property used in the trade or business for which a deduction is generally allowed under IRC § 167. A minimum tax equal to 10% of the modified taxable income of a taxpayer over the taxpayer's regular tax liability is created. We're over-simplifying these provisions for the sake of brevity. These rules are very complicated.

Comments: Internationally many countries are trying to combat base erosion and eliminate the benefits of artificially shifting income to tax havens. The legislation appears to go a long way in addressing these concerns.