

The November 9 release of the Senate Finance Committee Chairman's Mark has put into high gear the race to complete once-in-a-generation tax reform. A mere five hours after the House Ways and Means Committee completed a four-day markup and voted its legislation out of Committee along party lines (further discussed [here](#)), Senate Republicans released their "conceptual draft," which they plan to markup on Monday, November 13. Senate Republicans hope to vote on the bill the week after Thanksgiving. A common talking point among tax policy folks is that the Senate version will control and will be handed back to the House with a take-it-or-leave-it message. That said, our preliminary review of the Senate's conceptual draft has identified significant differences between the House and Senate proposals, suggesting a conference committee seems likely if each body passes a bill, unless the House simply accepts the final Senate bill, as it did with respect to the Senate 2018 budget resolution. We will update this portion of our assessment as the Senate Finance Committee markup continues, and as we continue to analyze the differences between the two proposals. In the event a true conference is necessary, there is no doubt that it would impact both the timing and substance of the Tax Cuts and Jobs Act. In an ideal scenario, the GOP still intends to finish tax reform by the end of the year, securing their much-needed political "win" before next year's midterm elections.

Herein, we highlight key aspects of the Senate Republican proposal, starting with an overview of key domestic provisions, followed by points applicable to multinationals.

Domestic Provisions

Businesses

- Corporate Rate – Starting in 2019, reduces the corporate tax rate to 20% and repeals the deduction for income attributable to domestic production activity
- AMT – Repeals the corporate alternative minimum tax, but limits the NOL deduction to 90% of taxable income
- NOLs – Repeals rules permitting the carryback of NOLs (other than for farming), but allows indefinite carryforward of post-2017 NOLs
- Immediate Expensing – Allows immediate and full expensing of plant and equipment for the next five years (six years for certain longer lived assets)
- Cost Recovery Period – Sets the cost recovery period for nonresidential real and residential rental property at 25 years and creates a class of property called "qualified improvement property" that has 10-year general recovery period and a 20-year alternative depreciation system recovery period
- Interest Deductibility – Limits the net interest deduction to 30% of "adjusted taxable income" but allows indefinite carryforward of the denied deduction, retains full deductibility for small businesses, public utilities and certain real estate-related businesses
- Like Kind Exchanges – Repeals like kind exchanges for all property other than real property
- Meals and Entertainment – Similar to the House bill, eliminates deductions for entertainment expenses and limiting the deduction for meals expenses to 50% in all cases
- Timing of Income Recognition – Requires income to be included in income no later than the year in which it is included in income in certain financial statements that a taxpayer may prepare
- Section 179 – Increases section 179 expensing for small businesses and raising the phaseout range
- Rehab Credit – Reduces the 20% rehabilitation credit to 10% and limiting eligible properties; also modifies the credit for clinical testing of orphan drugs, but not making changes to most other business credits
- Employee v. Independent Contractor – Liberalizes rules for determining when a service provider is an independent contractor rather than an employee and changes information reporting thresholds

Flow Thru Entities

- Gain on Partnership Sale – Taxes the gain on the sale of a partnership interest on a look-thru basis
- Partnership Losses – Expands the definition of substantial built-in loss for purposes of partnership loss transfers
- Pass-thru Entity Rate – Lowers tax on certain pass-thru business income with a special 17.4% "domestic qualified business income" deduction; the special deduction is limited to 50% of a taxpayer's wages properly allocated to "qualified business income," which does not include reasonable compensation, certain guaranteed partner payments or certain investment income; the special deduction is not available for specified services businesses, including law, engineering, architecture, accounting, health, consulting, financial and brokerage services or similar businesses

Tax-Exempt Bonds

- Refunding Bonds – Eliminates tax-exempt advance refunding bonds but, unlike the House bill, leaves untouched tax-exempt qualified private activity bonds, the use of tax-exempt bonds to finance professional sports stadia, and tax credit bonds; for more in-depth analysis, visit our *Public Finance Tax Blog* [here](#)

Executive Compensation

- Nonqualified Deferred Comp – Effectively eliminates elective nonqualified deferred compensation and accelerates the recognition of income by employees when there is no substantial risk of forfeiture
- Compensation Deductions – Eliminates deductions for compensation over \$1 million for public companies and introduces a companion excise tax on such compensation for tax-exempt employers
- Fringe Benefits – Reduces current and long-established fringe benefits

Estate Planning

- Death Tax – Doubles the federal estate and gift tax lifetime exemption of approximately \$5 million to approximately \$10 million

Individual Changes Affecting Businesses

- State and Local Tax Deduction – Repeals the deduction for all state and local taxes not incurred in connection with a business
- Mortgage Interest Deduction – Unlike the House bill, retains the current mortgage interest deduction
- Carried Interest – Retains current law rules relating to carried interest, but it is likely this issue will be addressed in the Senate Finance Committee markup

International Provisions

- Territorial System – Similar to the House bill, moves to a territorial system, exempting most foreign dividends from US tax
- Repatriation Tax – Transitions to this territorial system by taxing currently all existing offshore earnings; as in the House proposal, liquid assets would be taxed at a higher rate than illiquid assets and the taxpayer can elect to pay the resulting tax over eight years
- Offshore Intangibles Income – Includes an exception to the new territorial system for certain offshore income from intangibles, which is taxed currently
 - But adds incentives for US companies that exploit intangibles outside the US and incentives for “onshoring” intangibles that are currently offshore
- Hybrids – Disallows deduction of certain related-party payments to hybrid entities
- Inversion – Provides no preferential treatment for dividends from inverted companies
- DISC/IC-DISC – Repeals DISC and IC-DISC regimes

- Base Erosion – Imposes strong limits on US tax base erosion, including:
 - Imposing a tax on excess intangible income earned by foreign subsidiaries subject to low foreign taxes, coupled with incentives for US corporations that exploit their technology abroad from the US
 - Denial of excess interest deductions for US corporate members of world-wide groups to prevent disproportionate layering of debt on US members
 - Imposing a tax on certain payments by US corporations to foreign related parties where the US corporation receives US tax benefit with respect to the payment

What’s Next?

So here we are with all eyes on the Senate. Let us recap, then look ahead: Earlier this week, the Ways and Means Committee approved its bill by a party-line vote of 24-16, after including a last-minute amendment to bring the bill’s impact on the deficit below the \$1.5 trillion reconciliation threshold. The House Rules Committee will meet on Wednesday, November 15 to consider the House bill, signaling that a full House floor vote could take place on Thursday, November 16. Given that Speaker Ryan has reportedly set a record for closing down floor debate in the House, we are expecting a closed rule, with no amendments being offered on the House Floor.

Moving across the Capitol, as previously mentioned, the Senate Finance Committee plans to begin marking up their proposal at 3 p.m. on Monday, November 13. The markup is expected to last at least a week. Looking ahead, Senate Republicans plan to hold a floor vote the week after the Thanksgiving holiday.

That said, GOP leadership has at least two significant concerns they will have to deal with: political pressure from within the Republican Party and the Byrd Rule. First, significant differences exist between the House and Senate versions of the bill. For example, the Senate bill eliminates the state and local tax (SALT) deduction. After carefully crafting a key compromise in the House to allow deductions for property taxes up to \$10,000, House Republicans in high-income earning states would be back to square one in the Senate proposal. Importantly, House Republicans have a 22-vote margin of error in the House – and there are nearly 30 Republicans from California, New York and New Jersey who could oppose a bill that eliminates the SALT deduction. (Recall that the budget passed the House by the thinnest of margins. Was this carefully orchestrated to allow certain members to avoid taking tough votes, or was it a true reflection of the margin that Republicans are working within the House?) We expect other key differences to continue to surface as the process continues.

Second, and perhaps equally challenging, as currently drafted, the Senate’s conceptual draft is not Byrd-rule-compliant. Thus, during next week’s markup, look for significant discussion and major changes to the proposal, expirations of certain provisions or other limitations that could easily disrupt and derail the considerable progress that has been made to date.

All we can say is “hold on” – it’s going to be a bumpy ride.

Contacts

Matthew Cutts

Partner, Washington DC
T +1 202 457 6079
E matthew.cutts@squirepb.com

Donald Moorehead

Partner, Washington DC
T +1 202 457 5212
E donald.moorehead@squirepb.com

Linda Pfatteicher

Partner, San Francisco
T +1 415 954 0347
E linda.pfatteicher@squirepb.com

George Schutzer

Partner, Washington DC
T +1 202 457 5273
E george.schutzer@squirepb.com

Mitch Thompson

Partner, Cleveland
T +1 216 479 8794
E mitch.thompson@squirepb.com

Patrick N. Kirby

Associate, Washington DC
T +1 202 457 5294
E patrick.kirby@squirepb.com

The contents of this update are not intended to serve as legal advice related to individual situations or as legal opinions concerning such situations, nor should they be considered a substitute for taking legal advice.

© Squire Patton Boggs.