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NEWSFLASH: US TAX REFORMS HIGHLIGHTS – AT A GLANCE

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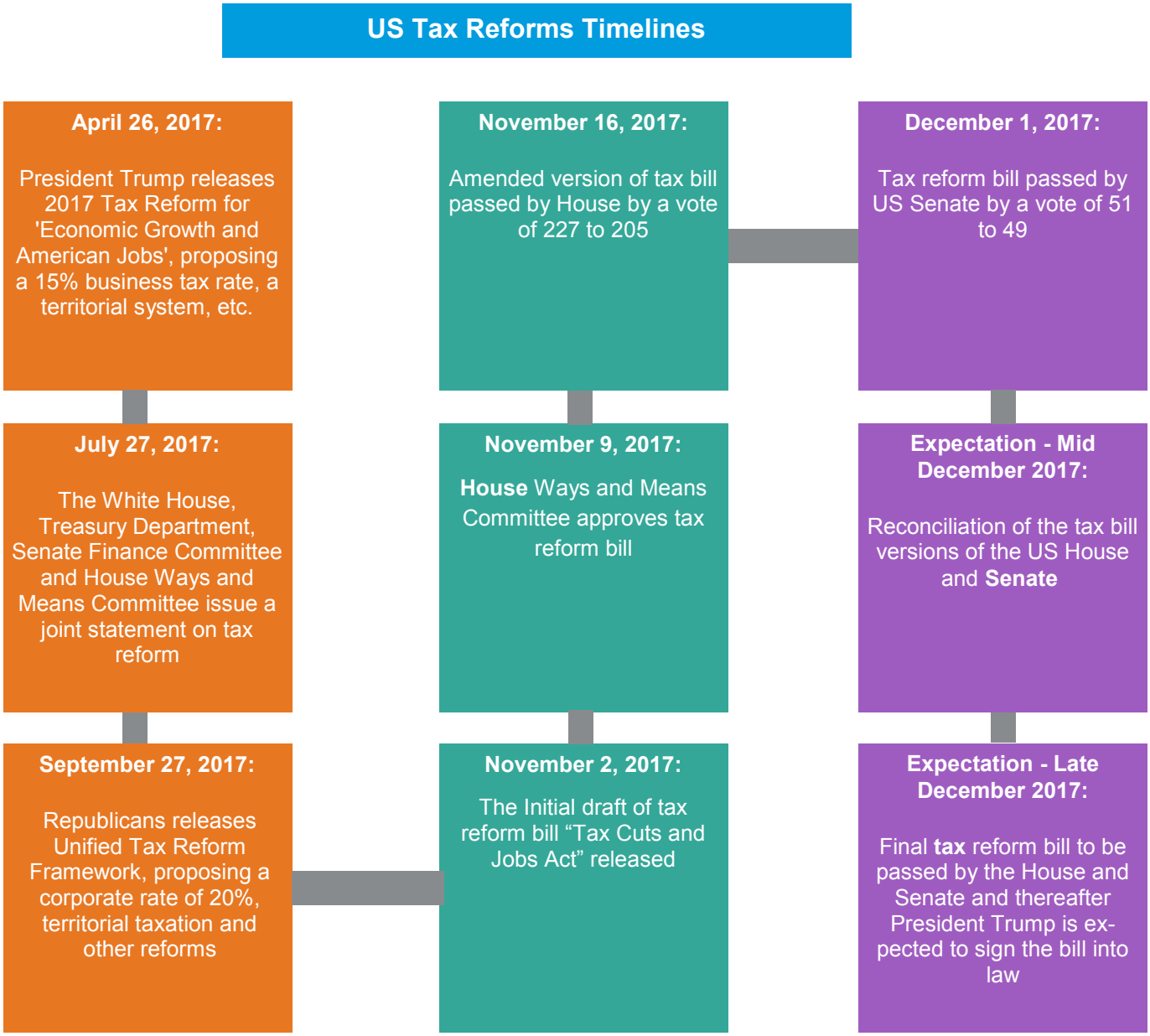
1.0 BACKGROUND – US TAX REFORM BILL

1.1 The US economy is the largest economy in the world and India's largest trade partner. A large number of Indian companies have US operations either through subsidiaries, joint ventures or branches and several groups have family members and executives working in the US for whom the reforms would have direct significant impact.

1.2 The US House of Representatives on 16 November 2017 voted 227 to 205 to pass the 'Tax Cuts and Jobs Act' ('House Bill'). Thereafter, the Senate Finance Committee passed a Senate version of tax reform legislation on 16 November 2017 approved by a vote of 14 to 12. The bill was then sent to the full Senate for its consideration. The tax reform proposals approved by the Finance Committee differ in key aspects from the House-passed bill. The Senate early on December 1 2017 voted 51 to 49 to pass an amended version of the tax reform bill previously reported by the Senate Finance Committee. The Senate adopted several significant changes to the Finance Committee bill in order to secure sufficient votes to pass the legislation. The Senate passed version of the 'Tax Cuts and Jobs Act' differs significantly from the House bill on certain matters.

1.3 This Newsflash highlights certain significant proposals made in the House Bill and the Senate Bill. The below is a limited overview of the progress so far and the timelines as well as certain significant reform measures, based on the current provision and is not a representation of the Final bill, which is yet to reach finality after the differences are reconciled.



2.0 CERTAIN PROPOSAL HIGHLIGHTS – HOUSE BILL / SENATE BILL

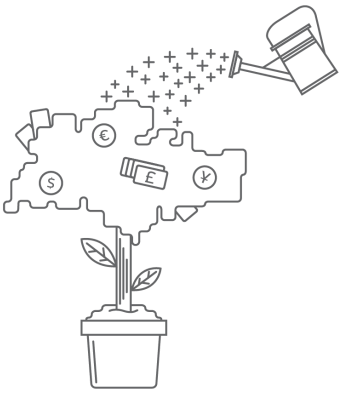
2.1 Summary – Key Highlights

ASPECTS	DESCRIPTION	HOUSE BILL (11/16/17)	SENATE BILL (12/1/17)*
Corporate rate reduction	Reduction in Corporate tax rate from 35% to 20%	✓	✓
Pass through rate reduction	Lower rates applicable to income earned through partnerships, s-corporations, etc .	✓	✓
Full Capex expensing	Immediate 100% expensing of qualified capital expenditures	✓	✓
Modification of NOL deduction	NOLs can only offset 90% of income, and NOL carrybacks are generally repealed	✓	✓
Limit on interest deductibility	Limits interest deductibility for businesses, subject to certain exceptions	✓	✓
Territorial taxation regime	Shift to a 'territorial' system, wherein foreign dividends to the extent received in US shall be exempt from tax. (*Referred to as 100-percent dividends received deduction (DRD) tax system*)	✓	✓
Repatriation toll tax on existing overseas profit	One time taxation on repatriation of Existing foreign Overseas Profits	✓	✓
Repeal of corporate AMT	Repeals corporate AMT	✓	×
Excise Tax On Certain Payments	Additional Tax on Outbound Payments to Related Parties abroad	✓	✓

**with some changes (Refer the below points for more details)*

2.2 Key Corporate Tax Proposals

2.2.1 Reduction in Corporate Tax Rates



- Both the House and Senate bills would permanently lower the top federal corporate tax rate to 20% from its current 35%.
- While the House bill proposes to permanently reduce the tax rates beginning with 2018, the Senate Bill proposes to reduce the rate with one year delay i.e. beginning 2019.
- In addition to the above, the Senate bill agreed to maintain the current corporate Alternate minimum tax of 20% while the House Bill proposes to repeal corporate AMT.

2.2.2 Limitation on deduction of Interest Expense

- The House proposes to introduce provision, keeping in line with Action Plan 4 of the Base Erosion and profit shifting (BEPS) recommendation of the OECD, to cap the net interest deduction at 30% of earnings before interest, taxes, depreciation and amortization (EBITDA). However, the Senate Bill proposes to caps it at the same rate i.e. 30% but of earnings before interest and taxes (EBIT).
- In addition, any disallowed interest would be carried forward indefinitely as per Senate Bill as opposed to the 5-year carryover in the House bill.
- The provision would apply to all businesses, regardless of form, and any disallowance or excess limitation would generally be determined at the filer level (e.g., at the partnership level instead of the partner level)

2.2.3 100% Immediate Expensing of Qualified Business Expense - “bonus” depreciation

- Senate bill and the House bill proposes to introduce increasing the first-year “bonus” depreciation deduction to 100% for investments made after September 27, 2017 and before January 1, 2023. This will allow taxpayers to write off the costs of equipment acquisitions as made.

- The Senate bill, proposes that the said provision shall apply only to new property as against the House Bill which would apply to both new and used property.

- The Senate bill also would phase down the percent expensed by 20% per calendar year beginning in 2023 (2024 for certain longer production period property and certain aircraft).

2.2.4 Pass-through Income - Tax Treatment

- Currently the pass through Income earned from a partnership, S corporation, or sole proprietorship is taxed at individual rates in the hands of the individual.

- It is proposed by the Senate bill to allow an individual taxpayer, a deduction for 23% of the individual’s domestic qualified business income from a partnership, S corporation or sole proprietorship, subject to certain limitation.

- House bill attempts to accomplish a similar result through an actual reduction in the applicable tax rate to 25% on business income of individuals from partnerships, S corporations, and sole proprietorships.

2.2.5 Net Operating Loss (NOL)

- **Carrybacks of NOL**: Senate Bill and House bill provides for the general elimination carrybacks of the Net Operating Loss as against the current law which provides carry-back upto 2 years.

- **Carryforwards of NOL**
  - Both version of Bills proposes to allow carry forward of NOLs for an unlimited period, as against 20 years under current law.

  - Further, both version of Bills proposes to limit the NOL deduction prospectively to 90 percent of the taxpayer’s pre-NOL taxable income.

  - In addition to the proposed provision under both the Bills, Senate bill proposes to further limit the NOL deduction to 80% of taxable income in tax years beginning after 2022.

2.2.6 Repeal of Deduction for Domestic Production

- Currently a deduction upto 9% is allowed on qualified income for items manufactured, produced, grown, or extracted in US. The original intent of the deduction was to provide a targeted corporate rate reduction that would allow U.S. companies to compete against international tax systems, while drawing international companies to the United States.

- The Senate bill proposes that the deduction for domestic production activities be repealed for tax years beginning after December 31, 2017 for taxpayers other than C corporations. For C Corporations in years beginning after December 31, 2018.

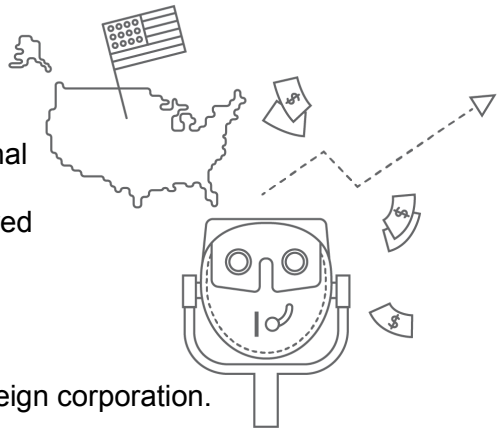
- The House bill included similar provision to repeal the deduction for income attributable to domestic production activities. However, the effective date of the repeal under that bill is tax years beginning after December 31, 2017 for all entity types.

2.2.7 Capitalisation of Research and Experimental Expenditures

- Under the Senate bill, amounts on account of research or experimental (R&E) expenditure as defined in the tax code, paid or incurred in tax years beginning after December 31, 2025 would be required to be capitalized and amortized over 5 years.

- House Bill proposes similar provisions but proposes to capitalize and amortize expenses over a 5-year period for expenditures paid or incurred after 2022.

2.3 Key International Tax Reform Provisions



2.3.1 Introduction of territorial Taxation Regime

- Both bill would change the current US 'worldwide' international tax system i.e. granting Foreign tax credits (FTC) to mitigate double taxation, to a 'territorial' 100-percent dividends received deduction (DRD) tax system.

- The bill would allow a domestic corporation that is a U.S. shareholder of a foreign corporation a 100% DRD for the foreign-source portion of dividends received from the foreign corporation.

- A corporate U.S. shareholder may not be able to claim FTC or deduction for foreign taxes paid or accrued with respect to any dividend allowed as a 100% DRD.

- However, the Senate bill provides that a DRD is not available for any hybrid dividend, which is generally defined as an amount received from a controlled foreign corporation ("CFC") for which the foreign corporation received a deduction or other tax benefit related to taxes imposed by a foreign country.

2.3.2 Repatriation Toll Tax on Existing Overseas Profit

- Currently under the tax laws, if any untaxed profits are repatriated into US, the Corporate would be liable to pay taxes at federal corporate tax rate.

- As a transition to the territorial system of taxation, both the bills are proposing a one-time tax on overseas profit, but at different rates.

- The House version deems a one-off repatriation of existing offshore profits at a rate of 14 per cent for liquid assets and 7 per cent for other assets, the Senate version sets that one-off repatriation tax at a rate of 14.49 per cent for liquid assets and 7.49 per cent (slightly higher than house version) for other asset.

- The bill would require this income inclusion in "the last tax year beginning before January 1, 2018.

2.3.3 Additional Tax on Outbound Payments to Related Parties abroad

- The House Bill provides that multinational firms would have to pay an "excise tax" of 20 percent on virtually all imports in US (other than interest payments) from related parties abroad, if deductible payments exceed USD 100 million on a three-year average. As per the House Bill, the excise tax can be averted by electing to treat the amount that would otherwise be subject to excise taxation as earnings effectively connected with the conduct of a trade or business in the US, carried out through a (fictitious) permanent establishment located within the US. Further, the Bill shall, unlike Senate Bill, allows for an ordinary foreign tax credit of up to 80 per cent of taxes paid or accrued with respect to the amounts taxed in the US.

– Senate Bill in contrast to the House Bill seeks to impose a “minimum tax” of 10% (to be increased to 12.5% from 2026) in addition to the regular US corporate tax burden, on profits of US companies or permanent establishments of the Foreign Company in US that belong to a multinational firm with more than USD 500 million annual turnover (three year average). The additional tax burden does not extend to all imports of goods; as a general rule, only the import of depreciable asset. The Senate bill furthermore provides that if the deductible cost associated with the imports from foreign related parties does not exceed 4 per cent of the total amount of expenses incurred by the respective US affiliate or PE, the minimum tax shall not be levied.

2.4 Key Individual Tax Proposals

2.4.1 The biggest difference between the House and Senate versions of the Tax Cuts and Jobs Act lies in the ways they would alter personal income tax brackets

House Version: Proposed Brackets, 2018			Senate Version: Proposed Brackets, 2018		
Single Filers			**Single Filers**		
Taxable income over	**Up to**	**Marginal rate**	***Taxable income over***	***Up to***	***Marginal rate***
$0	$45,000	12%	$0	$9,525	10%
$45,000	$200,000	25%	$9,525	$38,700	12%
$200,000	$500,000	35%	$38,700	$70,000	22%
$500,000	And up	39.6%	$70,000	$160,000	24%
			$160,000	$200,000	32%
			$200,000	$500,000	35%
			$500,000	And up	38.5%
Married Filers			**Married Filers**		
Taxable income over	**Up to**	**Marginal rate**	***Taxable income over***	***Up to***	***Marginal rate***
$0	$90,000	12%	$0	$19,050	10%
$90,000	$260,000	25%	$19,050	$77,400	12%
$260,000	$1,000,000	35%	$77,400	$140,000	22%
$1,000,000	And up	39.6%	$140,000	$320,000	24%
			$320,000	$400,000	32%
			$400,000	$1,000,000	35%
			$1,000,000	And up	38.5%

2.4.2 Standard Deduction

– The House bill proposes to raise the standard deduction to $24,000 for married couples filing jointly in 2018 (from $13,000 under current law), to $12,000 for single filers (from $6,500). The Senate version of the bill also proposes to raise the standard deduction with sunset clause to $24,000 for married couples filing jointly, $12,000 for single filers.

– In addition to the above, both the bill proposes to suspend / repeal various deductions (eg. state taxes, property tax, moving expense, etc) allowed to the individual while computing their taxable income.

2.4.3 Mortgage Interest Deduction

- Under current law, interest is allowed as an itemized deduction, subject to limitations. Qualified interest includes interest paid or accrued on debt incurred in acquiring, constructing, or substantially improving a taxpayer's residence and home equity indebtedness. Interest is deductible, regardless of how the proceeds of the debt are used, but such interest is not deductible in computing alternative minimum taxable income.

- In contrast to the House bill, the Senate bill would not reduce the amount of debt that can be treated as acquisition indebtedness from the current level of $1 million (House Bill proposal $ 500,000) or modify the treatment of interest attributable to mortgages secured by a second home (e.g. vacation homes).

- However, the Senate bill proposes to suspend the deduction for interest on home equity indebtedness for tax years 2018 through 2025.

2.4.4 Estate, gift and generation-skipping transfer tax

- The Senate bill proposes to double the basic exclusion amount from $5,000,000 to $10,000,000 per individual.

- This enhanced exclusion would apply to estates of decedents dying, generation-skipping transfers, and gifts made after 2017, but would sunset after December 31, 2025.

- Unlike the House bill, the Senate bill would not provide for future elimination of the estate and generation-skipping transfer taxes.

2.4.5 Itemised Deduction

- Under current law, the allowable amount of itemized deductions is reduced by 3% of the amount by which the taxpayer's adjusted gross income exceeds a threshold amount (referred to as the "Pease" limitation). Both the bill would repeal the overall limitation on itemized deductions

- In addition, the Senate Bill proposes a temporary reduction in medical expense for deduction. As per the Senate Bill individuals would be allowed to deduct qualified medical expenses in excess of 7.5% of adjusted gross income (AGI) for tax years 2017 and 2018 as against 10% as per the current law.

- Contrary to the Senate Bill, House Bill proposes to eliminate the itemized deduction for medical expenses for tax years beginning after December 31, 2017.

2.4.6 Individual AMT

- Unlike the House bill, the Senate bill does not repeal the AMT for individuals. Instead, the Senate bill temporarily increases the AMT exemption amounts and phases out thresholds for individuals

- The increased exemption amounts and phase out thresholds would sunset after 31 December 2025

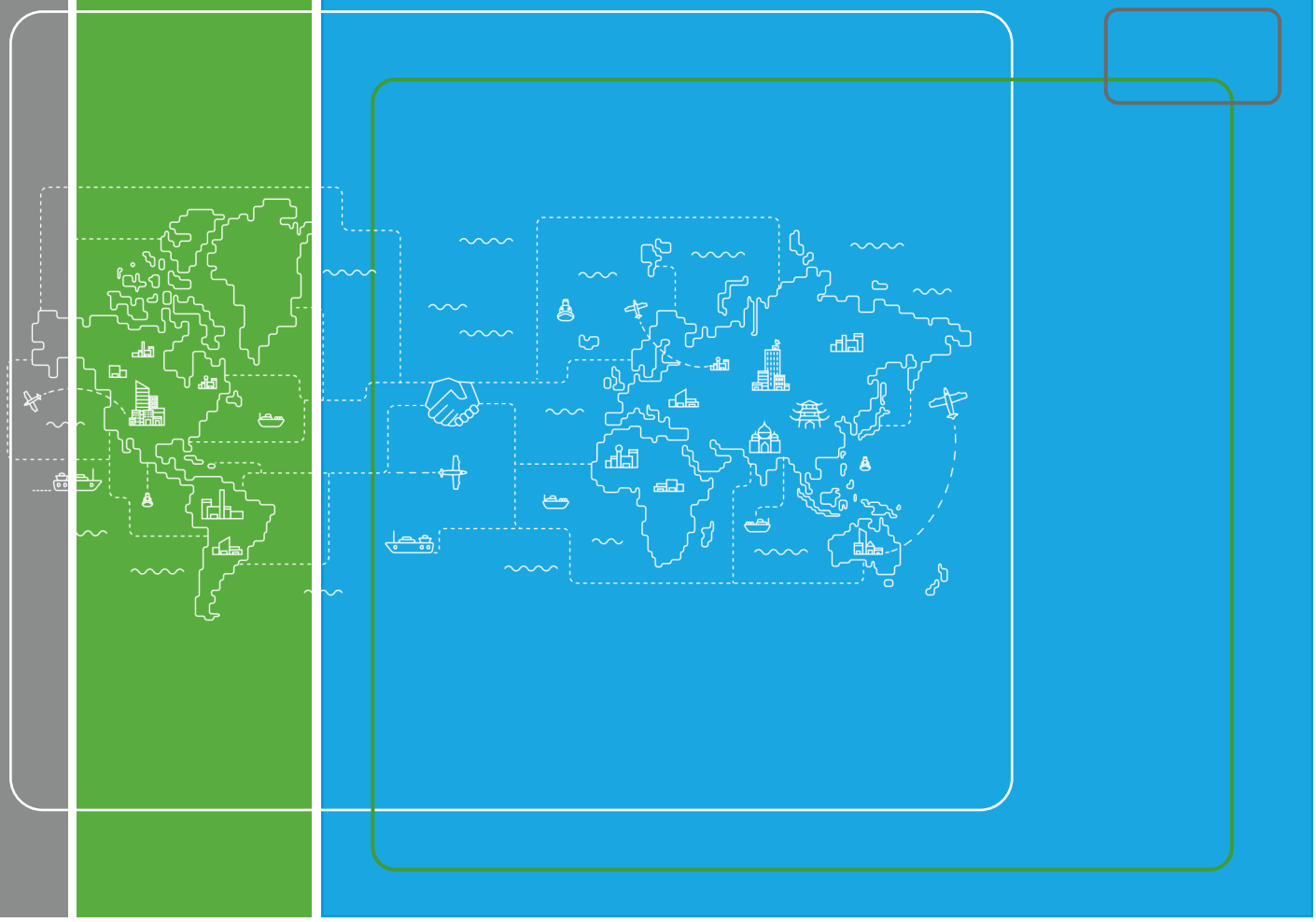
3.0 WHAT'S NEXT?

3.1 In order to resolve the differences, a conference may be convened of the Houses and that the final bill may simply reflect a compromise on the remaining items in dispute, or it may introduce entirely new ideas or provisions.

3.2 The focus of the cuts is a reduction in domestic corporate income taxes. Whether the bill should provide greater benefits for pass-through businesses and individuals were major issues in the Senate debate.

3.3 The bill would also make major changes to the treatment of foreign subsidiaries of U.S. corporations, which supporters believe will facilitate the 'repatriation' of previously untaxed foreign earnings from prior years. Supporters of the bill argue that the repatriation provisions and the tax reductions for U.S. businesses will lead to overall positive effects on economic growth, and that the taxes on that increased economic activity will recoup a good portion of the bill's nominal cost. As the close vote indicated, however, there are also many critics of the legislation.

3.4 RSM will monitor progress regarding developments in the legislative process, as well as regarding the potential impact of the final legislation on specific industries, entity types, and specific fact patterns



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