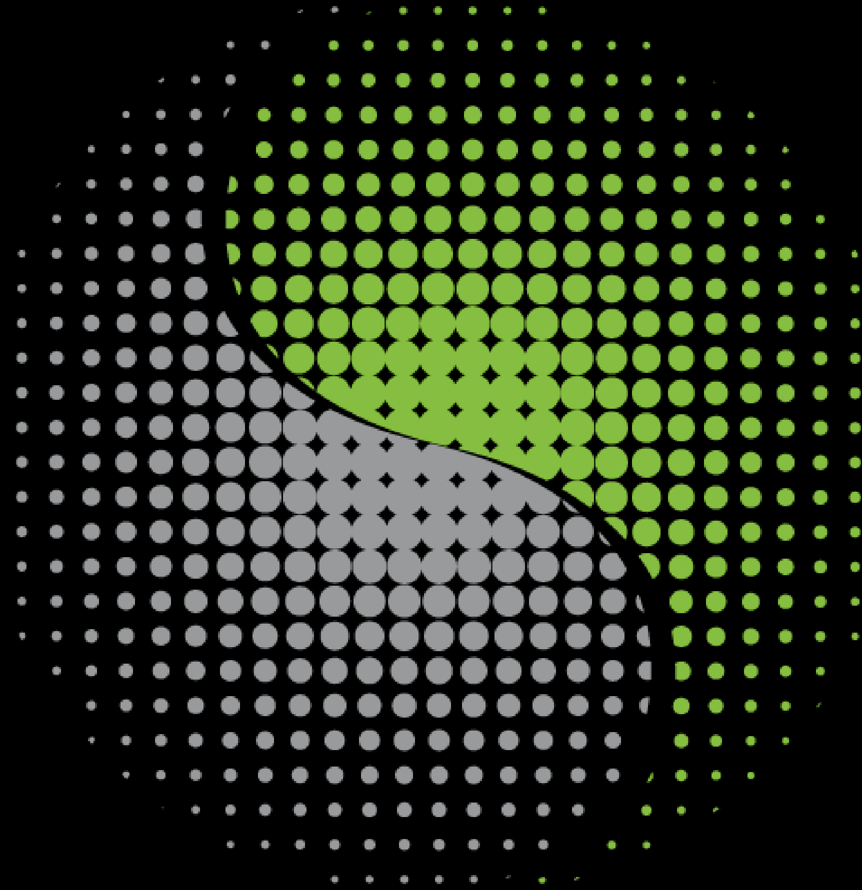

2017 Tax Reconciliation Bill

US Tax Desk
Deloitte Israel
December 26, 2017

Agenda

Overview of Tax Cuts and Jobs Act

International Tax Provisions

ASC-740

Selected Provisions Impacting the Israeli Marketplace

Q&A

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Overview of
Tax Cuts and Jobs Act

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2017 Tax Reconciliation Bill

Highlights

- Reduces corporate tax rate from 35% to 21%, effective in 2018
- Provides most passthrough owners with tax rates lower than what the individual side of code would generally provide
- Moves from worldwide business taxation to a participation exemption regime, with a deemed repatriation transition tax and several base-erosion measures
- Lowers individual tax rates
- Implements 100% immediate expensing for 5 years, with a phase-out thereafter
- Limits business interest deductibility
- Modifies treatment of net operating losses
- Repeals the §199 manufacturing deduction and repeals/limits various other business tax incentives
- Reduces corporate dividends received deduction
- Doubles standard deduction, eliminates personal exemptions, and increases child tax credit
- Repeals Pease limitation
- Repeals/limits many individual tax incentives
- Lengthens to 3 years the holding period requirement for carried interest gains

* **Note: Most individual provisions sunset after 2025**

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2017 Tax Reconciliation Bill

Business taxation

	Previous law	New law	Notes & observations
Corporate income	*35% top rate*	21% flat rate, effective for tax years after 12/31/17	Higher than President Trump's proposal of 15% or either chamber's initial 20% rate
Corporate dividends received deduction	*70% deduction; 80% if received from 20%-owned corporation*	Reduced to 50% deduction and 65% deduction	
Corporate AMT	*20% on alternative minimum taxable income*	Repealed • Credit available to offset regular tax liability for any taxable year • AMT credit refundable for any taxable years 2018-2021 at 50% (100% beginning in 2021) of the excess of the AMT credit for the year over the amount of the credit allowable for the year against regular tax liability	With corporate income and AMT rates both set at 20% in Senate bill, taxwriters belatedly realized AMT would be the default tax system for many companies, eliminating their ability to claim many credits, including for R&D.
Manufacturing deduction (§199)	*9% deduction on lesser of qualified production activity income or taxable income*	Repealed	
Net operating loss deduction	*2-year carryback and 20-year carryforward allowed to offset taxable income*	Limited to 80% of taxable income deductible • Repeals carrybacks except for small businesses and farms in certain casualty and disaster situations • Carryforward period made indefinite	• Lower than House-proposed 90% limitation • Property and casualty insurance companies exempt from changes • Carried forward NOLs not increased for inflation as in House version

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.

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2017 Tax Reconciliation Bill

Business taxation (cont.)

	Previous law	New law	Notes & observations
Capital expensing	*MACRS/ADS with bonus depreciation, or accelerated use of AMT credits; additional first-year depreciation deduction allowed equal to 50% of adjusted basis of qualified property acquired and placed in service before 1/1/20, with phase-down for most property placed in service after 12/31/17*	100% immediate expensing for qualified property through 2022, then phased down each year through 2026 (2023 = 80%, 2024 = 60%, 2025 = 40%, 2026 = 20%) • Modified rules for longer production period property and certain aircraft	• Applies to new and used qualified property acquired and placed in service after 9/27/17 • Exemption for real estate and certain public utilities • Generally exempts business with retail floor planning indebtedness
§179 expensing	*Allows current deduction for eligible property; $500k limit in a given year, phased out when cost of qualifying property >$2M*	Increases maximum amount of deduction to $1M and raises phaseout threshold to $2.5M • Expands definition of eligible property	
Business interest payments	*Generally deductible, with some limits in Section 163(j)*	Limited to business interest income + 30% of EBITDA through 2021, then 30% of EBIT • Indefinite carryforward for disallowed amounts	• Switches from House limitation to Senate limitation after 2021 • Exemption for real estate and certain public utilities, and for retail floor planning indebtedness • Exemption for businesses <$25M avg. annual gross receipts • A second worldwide test limiting interest deductibility, in the earlier House and Senate bills, was not included
Like-kind exchanges	*No gain or loss recognized for wide range of property held for productive use or investment; different classes of property include (1) depreciable tangible personal property; (2) intangible or nondepreciable personal property; and (3) real property*	Allowed only for real property	Exchanges of personal property permitted to be completed if begun before 12/31/17

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2017 Tax Reconciliation Bill

Business taxation (cont.)

	Previous law	New law	Notes & observations
Passthrough income	*Taxed at owner's individual rate*	20% deduction for qualified business income through 2025, limited to greater of a) 50% of W-2 wages, or b) 25% of W-2 wages + 2.5% of capital assets • Specified personal services businesses not eligible, except for taxpayers with taxable income <$157,500/$315,000 (deduction phased out over next $50k/$100k) • Taxpayers with taxable income <$157,500/$315,000 not subject to wage limitation (limitation phased in over next $50k/$100k)	• Generally follows Senate approach but decreases deduction from 23%; when new lower top individual rate taken into account, passthrough rate is approximately equivalent to Senate-passed provision • First time that passthrough entities will be separated from individual rate schedule • Personal services businesses include healthcare, law, consulting, accounting, athletics, financial services, brokerage services, investing, investment managements, or any business where the principal asset is the reputation or skill of its employees or owners; it does *not* include engineering or architecture services, as in earlier proposals • Personal services business and wage income limitation significantly lowered from Senate proposal in attempt to minimize loophole for high-income individuals • Trusts and estates eligible • Expands eligibility restrictions from Senate bill to make deduction more valuable to capital intensive businesses, such as real estate • Special rules apply to certain income from PTPs and dividends from REITs

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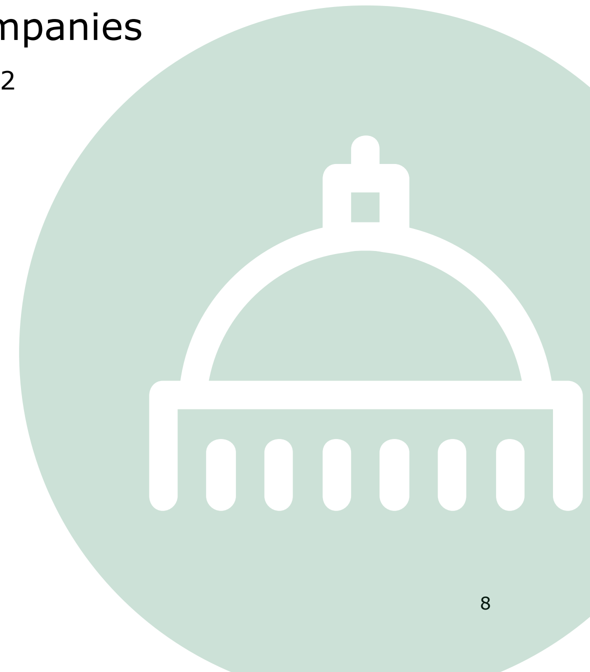
2017 Tax Reconciliation Bill

Business taxation

Some other provisions of note:

- Change treatment of contributions to capital[1]
- Repeal deduction for local lobbying expenses[1]
- Repeal deductions for entertainment, amusement or recreation activities, facilities, or membership dues, and most transportation fringe benefits provided to employees; 50% limitation through 2025 on food provided on site for employer's convenience (then repealed)
- Stronger limits on deduction for executive compensation >$1M; excise tax on certain executive compensation of tax-exempt organizations
- Modify numerous rules specific to insurance companies and to beer, wine and distilled spirits companies
- Require certain R&D expenditures to be amortized over 5 years if done in US; 15 if done abroad[2]
- Limit deductibility of FDIC premium payments
- Denial of deduction for certain fines, penalties, and settlement costs[1]
- Modify credit for orphan drug testing, and rehabilitation credit
- Allow temporary tax credit for paid family and medical leave[3]
- Repeal tax credit bonds and advance refunding bonds
- Create qualified opportunity zones[1]



[1] Effective date of enactment
[2] Effective for tax years after 12/31/21
[3] Effective for tax years 2018 and 2019

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2017 Tax Reconciliation Bill
International taxation

	Previous law	New law	Notes & observations
International taxation	*Worldwide regime with deferral and foreign tax credit offsets*	Participation exemption regime with 100% dividends received deduction • Available only to corporations	Generally ends use of foreign tax credits
Foreign-held earnings & profits	*US tax deferred until repatriated*	Deemed repatriation of previously untaxed post-1986 E&P at rate of 8% (non-cash) or 15.5% (cash & equivalents) • Applied to E&P as of 11/9/17 or 12/31/17, whichever is higher • Payable over 8 years • Claw-back of rate reduction if company inverts within 10 years after bill enactment	• Higher tax rates than in either House or Senate bill • Includes special rules for S corporations and REITs
Intangible property	*N/A*	20% tax on foreign-derived intangible income (FDII) with 37.5% deduction through 2025, then 21.875%	
"Base-erosion prevention" measures	*Subpart F rules limit deferral for certain types of passive and mobile income*	20% tax on "global intangible low-taxed income" (GILTI) with 50% deduction through 2025, then 37.5%	Follows Senate approach
		10% "minimum tax" on taxable income in excess of deductible payments to related foreign parties • Deduction denied for interest or royalties paid on certain hybrid transactions if no corresponding inclusion to related party or if related party is allowed deduction	Generally follows Senate approach

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2017 Tax Reconciliation Bill
Individual taxation

	Previous law	New law	Notes & observations
Individual income	*7 brackets* *Top rate of 39.6% on income >$418,400/$470,700 (single/married filing jointly), plus 0.9% Medicare tax on income >$200k/$250k*	7 brackets Top rate of 37% on income >$500k/$600k, plus 0.9% Medicare tax on income >$200k/$250k Sunsets 12/31/25	• Income thresholds indexed for inflation based on chained CPI instead of CPI (change does not sunset) • Creates significant marriage penalty • Does not include House’s bubble rate
Standard deduction	*$6,350/$12,700*	$12k/$24k through 2025	Indexed for inflation based on chained CPI after 12/31/19
Personal exemption	*$4,050 exemption for each member of household, phased out for higher AGIs*	Repealed through 2025	At Treasury Secretary’s discretion, current law wage withholding rules may remain the same for 2018
Limitation on itemized deductions	*Pease limitation for AGI >$261,000/$313,800*	Repealed through 2025	
Child tax credit	*$1k credit per child under age 17; phase out for AGI >$75k/$110k*	$2k credit per child under age 17 (refundable up to $1,400) and $500 per non-child dependent (non-refundable), through 2025 • Phase out increased to $200k/$400k • SSN required for each child, but not for non-child dependents	Indexed for inflation based on chained CPI

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2017 Tax Reconciliation Bill

Individual taxation (cont.)

	Previous law	New law	Notes & observations
AMT	*26%/28% on alternative minimum taxable income (AMTI); 2017 exemption $54,300/$84,500 (single/married filing jointly); phased out for AMTI >$120,700/$160,900*	Exemption increased to $70,300/$109,400 and phaseout thresholds increased to $500k/$1M, through 2025	Repeal of both individual and corporate AMT has long been a Republican goal, so retention of individual AMT is a surprise to many.
Estate tax, generation-skipping tax, and gift tax	*40% top estate, gift, and generation-skipping tax rate; exemption $5M/$10M, adjusted annually for inflation ($5.6M/$11.2M in 2018)*	40% estate and gift tax after exemption of $10M/$20M; increased exemption sunsets 12/31/25	• Stepped-up basis maintained • Modified exemption indexed for inflation after 2011 • No change made to generation-skipping tax
State and local tax (SALT) deduction	*State and local income and property taxes or sales taxes fully deductible*	Up to $10k of SALT deductible (any combination of property, income, sales taxes) • Deduction still allowed for taxes accrued in business • $10k not inflation indexed • Sunsets 12/31/25	• Allowing for deduction of property taxes, income taxes, or a combination is intended to appease different jurisdictions, but this remains one of the more contentious provisions for many House Republicans from high-tax states. • Prepayments of 2018 income taxes in 2017 treated as paid in 2018
Mortgage interest deduction	*Deduction on first $500k/$1M (married filing individually/all others) of debt used to secure primary or secondary residence, or first $50k/$100k of home equity debt*	Interest deductible on first $375k/$750k of acquisition indebtedness incurred after 12/14/17; home equity debt not deductible • Changes sunset 12/31/25, after which debt incurred at any time will be subject to current law	• Higher limitation than in House bill, and not limited to primary residence only

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2017 Tax Reconciliation Bill

Individual taxation (cont.)

	Previous law	New law	Notes & observations
Affordable Care Act	*Those who fail to maintain health coverage owe penalty of 2.5% of AGI, or $695 per adult/$347.50 per child in 2017*	Penalty lowered to $0, effective for months beginning after 12/31/18	Unlike most individual income tax provisions, does not sunset after 2025
Carried interest	*Taxed as long-term investment income*	Adds holding period requirement of 3 years for gains on carried interest in an investment or real estate interest	

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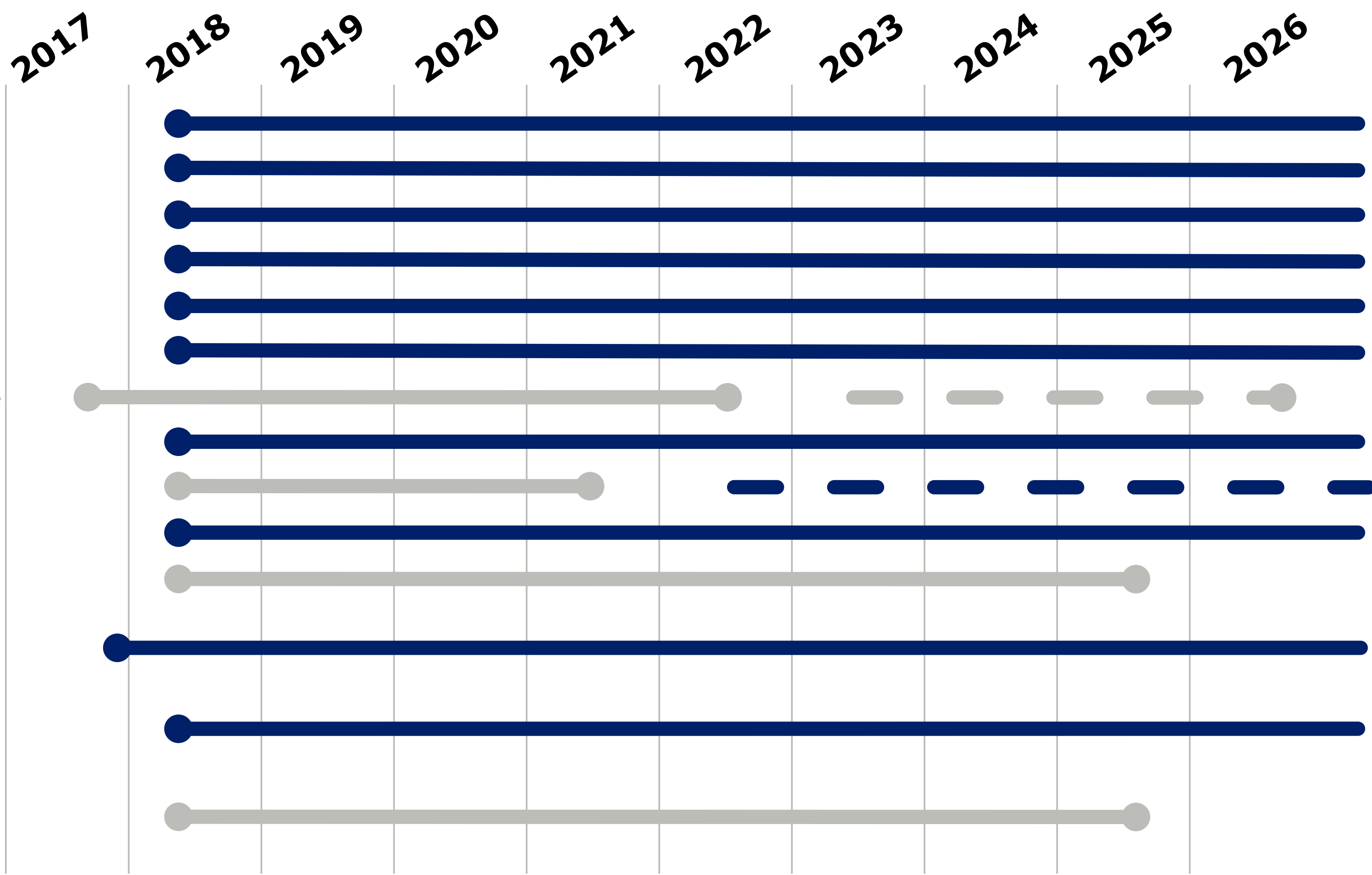
2017 Tax Reconciliation Bill

Business taxation – Effective dates

Permanent

Temporary

Lower corporate rate
International tax changes
Lower dividends received deduction
Repeal of AMT
Repeal of §199
Net operating loss deduction limitation
Immediate write-off for capital investment[1]
Higher §179 expensing cap and phaseout
Limitation on interest payment deduction[2]
Limitation on like-kind exchanges
20% deduction for passthrough income
Repeal of deduction for local lobbying expenses
Repeal of deduction for certain employer-provided fringe benefits
Allowance for limited deduction for employee food provided on-site



[1] Permitted first-year write-off phases down 2023-2026
[2] Stricter limitation after 2021

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International tax provisions

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Participation exemption

Participation exemption (IRC § 245A)

- 100% DRD for the “foreign-source portion” of dividends received by domestic corporations from “specified 10% owned foreign corporations”
- “Hybrid dividends” not allowed the DRD
- Hybrid dividends received by one CFC from another CFC treated as subpart F income
- Minimum 366-day holding period
- Effective for distributions made after 2017

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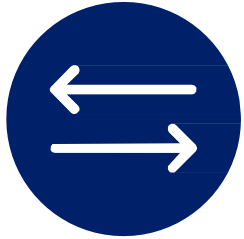
Transition tax



Transition tax (IRC § 965)

- Applies to US shareholders of "specified foreign corporations" ("SFCs")
- Tax rates: 15.5% to extent of (corporate) US shareholder's pro rata shares of SFCs' cash assets / 8% on remainder; proportional reduction in resulting deemed-paid taxes of corporate US shareholders
- Determine SFC's accumulated post-1986 foreign deferred earnings as of November 2 and December 31, without diminution by dividends distributed in its last tax year beginning before 2018 (other than dividends distributed to another SFC)
  - The greater number is added to the SFC's subpart F income for its last year beginning before 2018

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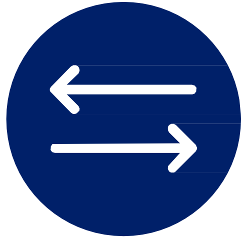
Transition tax



Transition tax (IRC § 965)

- US shareholder has income inclusion under IRC § 951(a)
  - Inclusion reduced by shareholder's pro rata shares of SFCs' deficits in post-1986 E&P as of November 2
- Secretary given authority to issue regulations to address double counting and non-counting of E&P, or to prevent the avoidance of the purposes of IRC § 965
- Election to pay over 8 years
- Additional timing accommodations relating to S corporations and REITs
- Generally applies to individuals as well as corporations
- Effective for the last tax year of a foreign corporation that begins before 2018, and with respect to US shareholders, for the tax years in which or with which such tax years of foreign corporations end

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Global intangible low-taxed income (GILTI)

US shareholder inclusion for GILTI (IRC § 951A) and corporate GILTI deduction (IRC § 250(a)(1)(B))

- US shareholder of CFCs includes in gross income its "global intangible low-taxed income" ("GILTI")
- Corporate US shareholder (other than RIC or REIT or S corp) generally allowed a deduction 50% of GILTI inclusion (37.5% for taxable years beginning after 2025)
- Deduction (together with the FDII deduction) limited by taxable income
- GILTI = excess (if any) of
  - The shareholder's "net CFC tested income" over
  - The shareholder's "net deemed tangible income return"

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Global intangible low-taxed income (GILTI)

US shareholder inclusion for GILTI (IRC § 951A) and corporate GILTI deduction (IRC § 250(a)(1)(B))

- Net deemed tangible income return = excess (if any) of
  - 10% of the aggregate of shareholder’s pro rata shares of the qualified business asset investment (QBAI) of CFCs, over
  - Interest expense taken into account in determining shareholder’s net CFC tested income for the taxable year (to the extent that the interest income attributable to such expense is not taken into account in determining its net CFC tested income)
- Net CFC tested income = excess (if any) of
  - Aggregate pro rata shares of CFCs’ tested incomes, over
  - Aggregate pro rata shares of CFCs’ tested losses

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Global intangible low-taxed income (GILTI)

US shareholder inclusion for GILTI (IRC § 951A) and corporate GILTI deduction (IRC § 250(a)(1)(B))

- A CFC's tested income (or loss) is its gross income (excluding certain amounts) less allocable deductions (including taxes)
- Exclusions:
  - ECI
  - Gross subpart F income
  - Gross income excluded from subpart F by the high tax exception
  - Dividends from related persons
  - FOGEI
- Foreign tax credits: Corporate US shareholder is deemed to pay 80% of the "inclusion percentage" × the foreign income taxes paid by each CFC that is attributable to the CFC's tested income, if any, taken into account by the shareholder under IRC § 951A
  - "Inclusion percentage" is the ratio of the shareholder's GILTI to the aggregate of its CFCs' tested incomes
  - Separate basket; no carryovers
- Effective for tax years of foreign corporations beginning after 2017 and for tax years of US shareholders in which or with which such tax years of foreign corporations end

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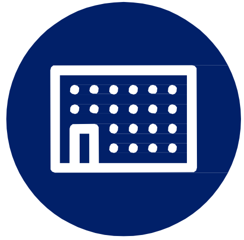
Corporate deduction for foreign-derived intangible income (FDII)



Deduction for domestic corporations’ “foreign-derived intangible income” (“FDII”)

- Subject to taxable income limitation, domestic corporation generally entitled to deduction for 37.5% (21.875% for tax years beginning after 2025) of foreign-derived intangible income
- Effective for tax years beginning after 2017

$$\textbf{FDII} = (\textbf{DEI} - \textbf{DTI}) \times \frac{\textbf{FDDEI}}{\textbf{DEI}}$$

Where--

DEI stands for “deduction eligible income”

DTI stands for “deemed tangible income”: the excess of DEI over 10% QBAI used to produce DEI

FDDEI stands for “foreign-derived deduction eligible income”

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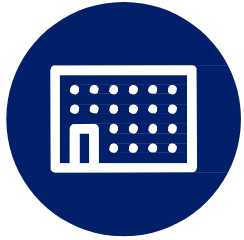
Corporate deduction for foreign-derived intangible income (FDII)



Deduction for domestic corporations' "foreign-derived intangible income" ("FDII")

- DEI--"deduction eligible income":
  - The excess of the gross income of the corporation, determined without regard to certain amounts, over the deductions (including taxes) properly allocable to such gross income.
  - Exceptions:
    - IRC § 951(a)(1) inclusions
    - IRC § 951A inclusions
    - Financial services income
    - Dividends from CFCs
    - Domestic oil and gas extraction income
    - Foreign branch income

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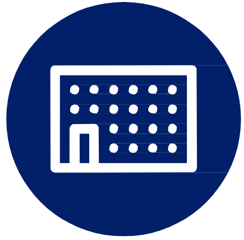
Corporate deduction for foreign-derived intangible income (FDII)



Deduction for domestic corporations' "foreign-derived intangible income" ("FDII")

- FDDEI--"foreign-derived deduction eligible income": generally, DEI derived in connection with
  - Property "sold" by the taxpayer to any person who is not a US person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or
  - Services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States
    - Special rules for related-party transactions; "sold" includes "licensed" and "leased"
- Only C corps (not RICs and REITs) can take deduction for FDII
- Effective for tax years beginning after 2017

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Base erosion and anti-abuse tax ("BEAT")

Base erosion and anti-abuse tax ("BEAT") (IRC § 59A)

- Imposes, on corporation that is an "applicable taxpayer," a tax equal to its "base erosion minimum tax amount" ("BEMTA")
- BEMTA is the excess of:
  - Percentage (see below) of "modified taxable income" ("MTI") over
  - Regular tax liability reduced by certain credits
- Percentage: for tax years beginning—

	Taxpayers generally	Banks and securities dealers
in 2018	5%	6%
after 2018 and before 2026	10%	11%
after 2025	12.5%	13.5%

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Base erosion and anti-abuse tax (“BEAT”)

Base erosion and anti-abuse tax (“BEAT”) (IRC § 59A)

- Prior to 2026, the following credits do not reduce regular tax liability for BEMTA computation purposes:
  - 80% of low-income housing credit, renewable electricity production credit, energy credit
  - 100% of research credit
- MTI = taxable income without regard to
  - deductions (“base erosion tax benefits”) for certain payments made to related foreign persons that give rise to deductions (“base erosion payments” (BEPs)), and
  - the “base erosion percentage” of the NOL deduction
- In the case of companies that become “inverted” after November 9, 2017, base erosion payments can also include cost of goods sold

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Base erosion and anti-abuse tax ("BEAT")

Base erosion and anti-abuse tax ("BEAT") (IRC § 59A)

- To be an "applicable taxpayer," the "base erosion percentage" must be at least 3% (2% for banks), and average annual gross receipts for the prior 3 years must be at least $0.5 billion (both computed on a group-wide basis)
- Payments for services at "cost" (with no markup) may be excluded from BEPs
- Taxpayers that mark derivatives to market (e.g., certain dealers) may be entitled to exclude "qualified derivative payments" from BEPs
- Applies to base erosion payments paid or accrued in tax years beginning after 2017

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ASC 740

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Effect of tax law changes

Timing [ASC 740-10-25-47]

Income tax effects of changes in tax law or rates are not recognized until enacted

- Existing deferred tax assets and/or liabilities at enactment date – impact recognized as discrete item in period change enacted
- Current year taxes payable/refundable – tax effect is recorded after effective date and reflected in AETR no earlier than period
that includes enactment date

Potential impact of select changes

1

Corporate rate reduction

- Re-measure deferred taxes and valuation allowance, if applicable
- Impact on ETR/AETR

2

Deemed repatriation ("transition tax")

- Calculate tax payable
- Calculation of "cash"
- E&P and foreign tax pools
- Remeasure any existing outside basis DTLs
- Assess impact on valuation allowance

3

Global intangible low-taxed income ("GILTI")

- Impact on deferred taxes and valuation allowance
- Impact on ETR/AETR

4

Base Erosion Anti-Abuse Tax ("BEAT")

- Impact on deferred taxes and valuation allowance
- Impact on ETR/AETR

5

Consider impact on valuation allowance for the following items:

- Business interest expense limitations
- Lost or modified business expense deductions
- Modifications to net operating loss deductions

Financial statement disclosure considerations

Footnote disclosures

- Income statement – Disclose significant components of income tax expense attributable to continuing operations, including adjustments of deferred tax assets/liabilities for enacted changes in tax laws or rates
- Disclose nature and effect of significant matters affecting comparability of information for all periods presented, if not otherwise evident

SEC disclosures

- SEC Reg. S-K (“Risk Factors”) requires disclosures of significant risks that could impact company in future
- SEC Reg. S-K (“MD&A”) requires disclosures of trends or uncertainties reasonably expected to have a material favorable/unfavorable impact

Selected Provisions Impacting the Israeli Marketplace

Israel Marketplace – General Observations

Rate Change

- Nearly all companies will be impacted by the reduction in the U.S. corporate tax rate from 35% to 21%. This change has been made with an aim towards making the U.S. more competitive relative to other countries around the world, including Israel. The narrowing of the disparity between the Israel and US rates may give some Israeli companies food for thought as they decide where to expand, and where they should house their Intellectual Property.
  - Israeli officials have already stated publicly that the local rate may need to be adjusted in order to remain competitive.

Interest

- Many Israeli companies are already leveraged to the extent allowable. The new provisions will constrain the allowable leverage in nearly all industries, with the exception of real estate, which is excluded from the new limitations (see below).
- In highly capital intensive businesses such as manufacturing, more leeway due to depreciation add-back for limitation purposes through 2021.

Capital Expensing

- Companies contemplating the formation or expansion of manufacturing activities in the U.S. should strongly consider the phase out of the 100% expensing provisions starting after 2022.
- Availability of capital expensing provisions to used property may be relevant to companies that have hesitated to purchase such assets in the past.

Israel Marketplace – General Observations (cont.)

Companies with U.S. Entities Compensated on a "Cost Plus" Basis

- Companies compensated by a foreign affiliate on a cost-plus basis should be deferring expenses. If bonuses have not been declared, should wait to declare until 2018, to take advantage of the reduced rate at which they will be taxed on income (because income is a function of costs, one of which is compensation).
- Bonuses declared in 2017 **MUST** be paid by 15/3/2018 (a Thursday) in order to avoid an adjustment that would result in an inclusion at a 35% rate

Low-Risk Distributors in the United States

- Bonuses declared in 2017 **MUST** be paid by 15/3/2018 (a Thursday) in order to avoid an adjustment that would result in an inclusion at a 35% rate

Israel Marketplace – General Observations (cont.)

Real Estate Companies

- Consider increasing leverage on any "blockers" used for non-U.S. investors.
  - New proposed 30% limitation on interest expense replaces the current section 163(j) rules and does not apply to real property trade or businesses.
  - As signed, it appears that there would be no limitation on interest paid by a C corporation "blocker" owning real estate, other than debt/equity concerns. If elected not to be subject to 30% interest limitation, real residential and commercial property must be depreciated over 30/40 years respectively.
- However, companies must consider whether related party interest and royalty payments implicate the base erosion anti-hybrid provisions, which require a corresponding inclusion in a related company.
- Passthrough real estate companies may qualify for a reduced tax rate on ongoing income, resulting in approximately a 29.6% rate on the annual operating income (in practicality, very little, if any, taxable income flowing up from the U.S. entities).
- REITs may warrant additional consideration as an investment vehicle going forward.
- Consider reviewing current structures in light of the new corporate tax rate.

Q&A

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