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COMPARISON OF PROVISIONS RELATED TO PASS-THROUGHS IN HOUSE AND SENATE BILLS, December 5, 2017

	HOUSE BILL	SENATE BILL

Individual Tax Relief for Qualified Business Income of Pass-Throughs	• Provides for a maximum 25 percent ordinary income tax rate that would apply to the "qualified business income" ("QBI") of individuals engaged in business activities of sole proprietorships, tax partnerships, and S corporations. Business income not qualifying as such would remain subject to the normal ordinary income tax rate schedule.
	• The determination of whether income is QBI depends on whether such income is derived from passive or active business activities (determined in accordance with the current section 469 material participation rules).
	    o Income of passive owners would be treated entirely as QBI. A 30/70 rule would apply to income derived from active business activities (30 percent, or the "capital percentage," would be treated as QBI, while the remaining 70 percent would be subject to ordinary income tax rates).
	    o Active business owners may elect to apply a formula based on the facts and circumstances of their business to determine a capital percentage of greater than 30 percent. The formula would measure the capital percentage based on a rate of return (federal short-term rate plus seven percentage points) multiplied by the capital investments of the business that are not debt-financed. The election of this alternative formula would be binding for a five year period.
	• Certain items, such as income subject to preferential rates (e.g., qualified dividend income and net capital gains) and certain investment income (e.g., short-term capital gains, dividends, and foreign currency gains and hedges unrelated to business needs) would not be eligible to be recharacterized as QBI.
	• The carryover business loss from the preceding taxable year reduces QBI in the current taxable year.
	• An owner's or shareholder's capital percentage would be limited if actual wages or income treated as received in exchange for services
		• Allows for an individual taxpayer deduction in an amount equal to 23 percent of domestic qualified business income ("QBI") from sole proprietorships, tax partnerships, and S corporations. Such deduction would automatically sunset after December 31, 2025.
		• QBI is defined as the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business of the taxpayer. If the net amount of such qualified items of income, gain, deduction, and loss with respect to qualified trades or businesses of the taxpayer for any taxable year is less than zero, such amount shall be treated as a loss from a qualified trade or business in the succeeding taxable year.
		• "Qualified items of income, gain, deduction, and loss" generally include all business income other than investment income (generally dividends, investment interest income, short-term capital gains, long-term capital gains, commodities gains, foreign currency gains, etc.). Unlike the House bill, such income is limited only to QBI that is effectively connected with the conduct of a U.S. trade or business.
		• "Qualified trade or business" means any trade or business other than a specified services business or the trade or business of performing services as an employee.
		• QBI does not include any amount paid to the relevant taxpayer (such as from an S corporation) that is treated as reasonable compensation (as determined under current law), nor does it include any amount paid by a partnership that is a guaranteed payment under section 707(c) or a section 707(a) payment for services.
		• The 23% deduction is further limited to 50 percent of the taxpayer's allocable or pro rata share of W-2 wages of the partnership or S corporation, or 50 percent of the W-2 wages of the sole proprietorship. The W-2 wage limit does not apply in the case of a taxpayer with taxable income not exceeding $500,000 for MFJ or $250,000 for other individuals. The W-2 wage limit is then phased in for individuals with taxable income exceeding $500,000/$250,000 over the next $100,000 of taxable income for MFJ or $50,000 for other individuals.
		• The deduction is generally not available for specified services businesses. However, an exception is provided for taxpayers under a certain income threshold ($500,000 MFJ, $250,000 for other individuals). The exception is phased out for individuals with taxable income exceeding $500,000/$250,000

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	from the pass-through entity (such as a guaranteed payment) exceeds the taxpayer's otherwise applicable capital percentage. • The default capital percentage for specified services business would be zero percent. However, such businesses could elect annually to use an alternative capital percentage if otherwise in excess of 10%. Such election is intended to provide some relief to personal service businesses that have significant capital investments. • There is a special phased-in-over-five-years lower individual income tax rate (9 percent) for active owners of pass-through businesses for up to $75,000 of their net business income, even from specified service businesses (for MFJ owners with taxable incomes less than $150,000 and then fully phased out at taxable income of $225,000). Lower thresholds apply to non-MFJ individuals.	over the next $100,000 of taxable income for MFJ or $50,000 for other individuals. • The deduction can be applied to specified agricultural or horticultural cooperative income and the distributive share of publicly-traded partnership income (and any ordinary income from disposition of units therein).
Partnership Interest Held in Connection With the Performance of Services ("Carried Interest")	• Would impose a three-year holding period requirement for qualification as long-term capital gain with respect to certain partnership interests received in connection with the performance of services.	• Would impose a three-year holding period requirement for qualification as long-term capital gain with respect to certain partnership interests received in connection with the performance of services.
Limitation on Losses for Taxpayers Other Than Corporations	• No counterpart	• Would provide that "excess business losses" of a taxpayer other than a C corporation are not allowed for the taxable year, but rather are carried forward and treated as part of the taxpayer's net operating loss carryforward in subsequent taxable years. Essentially disallows excess active net business losses, effectively extending the current treatment of net passive activity losses to active losses. • An excess business loss is the excess of aggregate deductions of the taxpayer attributable to trades or businesses of the taxpayer, over the sum of aggregate gross income or gain of the taxpayer with respect to such trades or businesses plus a threshold amount. Such threshold is $500,000 MFJ and $250,000 for other individuals. • In the case of a partnership or S corporation, the proposal applies at the partner or shareholder level.
Tax Gain on the Sale of a Partnership Interest on Look-	• No counterpart	• Would overrule *Grecian Magnesite Mining v. Commissioner* and codify Revenue Ruling 91-32, such that gain or loss from the sale or exchange of a partnership interest is effectively connected with a U.S. trade or business to the extent that the transferor would have effectively connected gain or loss had the partnership

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Through Basis (Repeal of *Grecian Magnesite*)		sold all of its assets at fair market value as of the date of the sale or exchange. • Any gain or loss from the hypothetical asset sale would be allocated to interests in the partnership in the same manner as non-separately stated income and loss. • The transferee of a partnership interest must withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien or foreign corporation; similar to the current FIRPTA withholding/reporting regime.
Modification of the Definition of Substantial Built-In Loss in the Case of Transfer of a Partnership Interest	• No counterpart	• Would expand the definition of a substantial built-in loss for purposes of section 743(d). Under current law, a substantial built-in loss exists if the partnership's adjusted basis in its property exceeds by more than $250,000 the fair market value of the partnership property. The bill would provide that a substantial built-in loss also exists if the transferee would be allocated a net loss in excess of $250,000 upon a hypothetical disposition by the partnership of all the partnership's assets in a fully taxable transaction for cash equal to the assets' fair market value, immediately after the transfer of the partnership interest.
Modification of Section 704(d) Outside Basis Limitation on Partner Losses	• No counterpart	• Would expand the section 704(d) outside basis limitation on partner losses to provide that generally a partner's distributive share of charitable contributions (based on tax basis of contributed property) and foreign tax expenditures are allowed only to the extent of the partner's outside basis at the end of the partnership taxable year in which the expenditure occurs.
Partnership Technical Terminations	• Would repeal the partnership technical termination rule. Thus, a partnership would be treated as continuing even if more than 50 percent of the total capital and profits interests of the partnership are sold or exchanged within a year, which would prevent partnerships from being required or being permitted to make new elections for various accounting methods, depreciation lives, and other purposes.	• No counterpart
Modification of Treatment of S Corporation Conversions to C Corporations	• Would provide that in the case of a distribution of money by an eligible terminated S corporation after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.	• Would provide that in the case of a distribution of money by an eligible terminated S corporation after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits. • An "eligible terminated S corporation" means any C corporation which (i) was an

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	• An "eligible terminated S corporation" means any C corporation which (i) was an S corporation on the day before the date of the enactment of the tax reform legislation and made a revocation of its S corporation election in the 2 year period following such date, and (ii) the owners of the stock of such corporation on the date of the revocation of the S corporation election are the same owners (and in identical proportions) as on the date of the enactment of the tax reform legislation. • Would provide that in the case of an eligible terminated S corporation, any taxable income adjustment arising from such a conversion under section 481 would be taken into account ratably over 6 years (e.g., from having to switch from the cash method to the accrual method of accounting).	S corporation on the day before the date of the enactment of the tax reform legislation and made a revocation of its S corporation election in the 2 year period following such date, and (ii) the owners of the stock of such corporation on the date of the revocation of the S corporation election are the same owners (and in identical proportions) as on the date of the enactment of the tax reform legislation. • Would provide that in the case of an eligible terminated S corporation, any taxable income adjustment arising from such a conversion under section 481 would be taken into account ratably over 6 years (e.g., from having to switch from the cash method to the accrual method of accounting).
Expansion of Qualifying Beneficiaries of an Electing Small Business Trust ("ESBT")	• No counterpart	• Would permit a nonresident alien to be a potential current beneficiary of an ESBT. Currently, an ESBT may be a shareholder of an S corporation. Eligible beneficiaries of an ESBT include individuals, estates, and certain charitable organizations eligible to hold S corporation stock directly; however, a nonresident alien individual may not be a potential current beneficiary of an ESBT under current law.
Charitable Contribution Deduction for ESBTs	• No counterpart	• Would provide that the charitable contribution deduction of an ESBT is not determined by the rules generally applicable to trusts but rather by the rules applicable to individuals. Thus, the percentage limitations and carryforward provisions applicable to individuals would apply to charitable contributions made by the portion of an ESBT holding S corporation stock.
Like-Kind Exchanges of Real Property	• Limits current-law nonrecognition of gains and losses from like-kind exchanges by limiting its application to real property that is not held primarily for sale.	• Limits current-law nonrecognition of gains and losses from like-kind exchanges by limiting its application to real property that is not held primarily for sale.
Deduction Limit on Net Business Interest Expense	• Business interest deductions limited to sum of business interest income plus 30% of "adjusted taxable income," which is increased by depreciation, amortization, and depletion. • Disallowed business interest deductions can be carried forward for up to 5 years. • Such limit on interest deductions inapplicable to certain small businesses (3-year average annual gross receipts do not exceed	• Business interest deductions limited to sum of business interest income plus 30% of "adjusted taxable income," which is not increased by depreciation, amortization, and depletion. • Disallowed business interest deductions can be carried forward indefinitely. • Such limit on interest deductions inapplicable to certain small businesses (3-year average annual gross receipts do not exceed $15M).

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	$25M).	
Net Operating Losses	• Limits the NOL deduction to 90% of taxable income (without regard to the NOL deduction). • NOL carrybacks generally eliminated, and indefinite carryforward with inflation adjustment.	• Limits the NOL deduction to 90% for tax years 2018-2022 and to 80% for tax years after 2022 (without regard to the NOL deduction and the 23% QBI deduction). • NOL carrybacks eliminated, and indefinite carryforward (but no inflation adjustment).
Individual AMT	• Repealed	• Retained, with slightly higher amounts of income exempted therefrom • 23% QBI deduction does not appear to be limited by individual AMT.