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HOUSE TAX REFORM PROPOSAL – PASS-THROUGH BUSINESSES

The following chart sets forth some of the provisions affecting pass-through businesses in the House's version of the Tax Cuts and Jobs Act, as approved by the House on November 16, 2017. This chart highlights only some of the key issues and is not intended to address all aspects of the proposed legislation. If you have any questions, please contact your Andersen Tax advisor.

As of November 16, 2017

PASS-THROUGH BUSINESSES		
Provision	**Description of Proposed Change**	**Comments**
Tax Rate on Partnership and S Corporation Business Income	The tax rate on partnership or S corporation business income that flows through to its partners or its shareholders would be reduced as low as 25%, which is more than a third less than the regular maximum individual tax rate of 39.6%. The 25% rate would apply to business income as long as the partner or shareholder is a passive investor in the partnership as determined under the long-standing passive-activity loss rules. If the partner or shareholder is active, then the 25% rate would only apply to 30% of the business income with the remainder 70% taxed at regular tax rates, but the 30% may be increased for capital intensive businesses. Partners or shareholders in service businesses would generally not qualify for any reduced rate. The bill amendments provide for a 9% tax rate in lieu of the 12% rate for the first $75,000 ($37,500 if unmarried and $56,250 for heads of households) in net business taxable income of an active owner earning less than $150,000 in taxable income. As taxable income exceeds $150,000 ($75,000 if unmarried and 112,500 for heads of households), the 9%-rate benefit is phased out at $225,000 of taxable income. This 9% rate is phased in over a five-year period.	REIT ordinary income distributions should also be eligible for the 25% rate. While capital gains are not eligible for this special rate, the bill does not eliminate the preferential tax rate for long term capital gains (LTCGs) recognized by individuals. Thus, LTCGs of individuals are taxed at a maximum rate of 20%.
Contributions to Capital of a Partnership or S corporation	Gross income of a partnership or S corporation would include contributions to its capital to the extent the amount of money and the fair market value (FMV) of property contributed to the partnership or S corporation exceeds the FMV of any partnership interest or stock that is issued in exchange for the contribution.	This provision would not impact Sec. 351 or 721 contributions.
Income From Trade or Business of Partnership or S Corporation – Self Employment Income	No proposed change. A provision that would have modified rules for self-employment income was included in a version of the Tax Cut and Jobs Act bill, but it was removed by amendment.	It is possible further changes will be proposed that would expand the applicability of the self-employment tax.

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Deemed Termination (i.e., Technical Termination) of a Partnership	The bill would eliminate the tax technical termination rule that says if within a 12-month period there are sales or exchanges of interests in a partnership that equal or exceed 50% of the total interest in partnership profits and capital, then the partnership is deemed terminated for tax purposes.	This hyper-technical rule can serve to reset the clock for depreciating a partnership's assets, which can lower the annual depreciation deduction and increase a partner's tax bill. The bill would eliminate this trap for the unwary.
Carried Interest	For partnership interests held with respect to services, the bill would require that gains with respect to such interest have a three-year holding period to qualify for long-term capital gains treatment.	Currently, taxpayers benefit from carried interest at capital gain rates. This proposal would have a negligible impact to carried-interest holders in private equity firms, which tend to hold onto assets for a longer period of time, but may impact such holders in hedge funds depending on the turnover of the assets and holding period. A more substantial carried interest proposal could arise through further amendments or in the Senate.
S Corporations – Converting to C Corporations	If a corporation is an S corporation on the day before the law is enacted and converts to a C corporation by revocation during the following two years and has the same owners (and in identical proportions) on the date of enactment date and the date the S Corp election is revoked, then (1) any increase in tax due to a change in accounting methods attributable to the revocation is taken into account ratably over six years, and (2) cash distributions after the post-termination transition period are treated as coming proportionately from the accumulated adjustments account and from C corporation earnings and profits rather than first coming from the accumulated adjustment account and then earnings and profits.	

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