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Update on the Enactment of the Tax Cuts and Jobs Act

On December 22, 2017, President Trump signed Public Law No. 115-97, formerly known as the "Tax Cuts and Jobs Act" (the "Act"), into law. The Act makes a number of major changes to the U.S. federal income taxation of both individual taxpayers and businesses, including:

- creating a preferential rate for income from certain types of businesses operated in pass-through form, by allowing a 20% deduction for such income,
- changing the rules for carried interest by increasing the required holding period for long-term capital gains to three years with respect to certain gains generated by certain investment management businesses,
- permanently reducing the corporate income tax rate from 35% to 21% and repealing the corporate alternative minimum tax ("AMT"),
- imposing limits on the deductibility of business interest and the utilization of net operating losses ("NOLs"),
- changing to a partial territorial system of international taxation while introducing new provisions designed to combat base erosion,
- modifying the tax brackets for individuals and reducing marginal tax rates, with the highest marginal rate for individuals reduced from 39.6% to 37%,
- increasing the standard deduction and limiting or eliminating various itemized deductions for individuals,
- increasing the AMT exemption amounts and phase-out thresholds for individuals,
- doubling the federal estate, gift and generation skipping transfer tax exemptions, and
- significantly expanding the scope of the Section 162(m) compensation deduction limitation and extending the principles of Section 162(m) to compensation payments made by tax-exempt organizations.

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The legislative process for passing the Act was hurried and left many technical issues and potential drafting errors unresolved. The IRS and Treasury are likely to undertake sizable regulatory projects to provide guidance with respect to many aspects of the Act. Before those regulatory projects are completed, taxpayers may be left applying ambiguous and, in some cases, flawed statutory language.

We summarize below certain key provisions of the Act. Unless otherwise noted, the changes discussed are effective for taxable years beginning after December 31, 2017.

Partnerships and Other Pass-Through Entities

Pass-Through Rate

Individuals, trusts and estates may now deduct 20% of domestic "qualified business income" received from partnerships and other pass-through entities (including S corporations), resulting in a top rate on "qualified business income" of 29.6% (assuming full deductibility, which may often not be the case, as discussed below), given the new top marginal rate of 37%.

Under these new rules, "qualified business income" generally includes items of income, gain, deduction and loss with respect to a business operated in the United States in pass-through form, but does not include amounts paid as reasonable compensation, amounts received as guaranteed payments for services or investment income. For taxpayers whose taxable income exceeds certain thresholds ($157,500 in the case of a single taxpayer, $315,000 in the case of a joint taxpayer), the deduction is limited for each qualified trade or business from which the individual receives income. For such taxpayers, the deduction generally is limited to the greater of such taxpayer's allocable share of (1) 50% of the W-2 wages paid with respect to the qualified trade or business or (2) the sum of 25% of the W-2 wages paid with respect to the qualified trade or business plus 2.5% of the unadjusted basis, immediately after the acquisition, of all "qualified property" (generally, tangible depreciable property used in the production of qualified business income). As a result of these limitations, the pass-through deduction will not apply to all pass-through income and many taxpayers otherwise eligible for the deduction but conducting businesses with few wage earners and/or limited tangible assets will be taxed on qualified business income at a higher rate than the 29.6% rate noted above.

The 20% deduction is not available for income realized from "specified service trades or businesses" such as health, law, accounting, consulting, financial services firms and other businesses where the principal asset of such trade or business is the reputation or skill of one or more of its employees, unless realized by a taxpayer whose taxable income falls below the relevant threshold described above. The 20% deduction applies to dividends from real estate investment trusts ("REITs") that are not capital gains dividends or qualified dividends, as well as net qualified income from publicly traded partnerships, without regard to the limitations applicable to income from other types of pass-through businesses described above.

These new rules generally will be most beneficial to passive investors in businesses (other than "specified service trades or businesses") that generate ordinary income, such as investors in large real estate development partnerships. In contrast, most partners in management companies of investment funds will not benefit with respect to management fee income because such income is from a "specified service trade or business." We expect that certain planning opportunities will evolve to allow taxpayers otherwise not obviously eligible for the deduction to benefit from it. Unlike the corporate tax rate cut to 21% discussed below, the deduction for qualified business income received from pass-through entities is set to expire on December 31, 2025.

Sale of Partnership Interests by Non-U.S. Partners

The Act overrides the holding of a recent U.S. Tax Court case[1] by providing that a non-U.S. partner's sale of an interest in a partnership engaged in a U.S. trade or business results in income effectively connected with a U.S. trade or business ("ECI") to the extent such partner would have realized ECI upon a hypothetical sale of assets by the partnership as of the date of the sale or exchange of the partnership interest. To implement this new rule, the Act requires transferees of partnership interests to withhold 10% of the entire amount realized on the sale or exchange of such an interest unless the transferor partner provides certification of non-foreign status. If a transferee fails to withhold the correct amount from the transferor, the partnership will be required to deduct and withhold that amount from distributions made to the transferee partner. The rules treating gain on a sale or exchange of a partnership interest as ECI are effective for dispositions on or after November 27, 2017, with the related withholding provisions effective for dispositions after December 31, 2017 (though the IRS in administrative guidance released shortly after the enactment of the Act has suspended withholding with respect to interests in publicly-traded partnerships for the time being).

There may be interesting applications of this withholding tax rule, such as with respect to redemptions in hedge funds holding ECI generating assets. This provision can also have unexpected and potentially inappropriate consequences with respect to some transfers. For example, it is currently not clear whether the tax and the withholding obligation will apply in the context of non-recognition transfers, though a literal reading of the statute may lead to this result. We expect that the IRS and Treasury will write regulations or other guidance that will make this regime look similar to the existing withholding regime under the FIRPTA rules. Until that occurs, we expect parties will address these withholding issues contractually and structurally by ensuring domestic entities hold interests in partnerships engaged in U.S. trades or businesses. The withholding tax issues likely will create friction and additional transaction costs in routine transfers of investment funds and other transactions.

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[1] *Grecian Magnesite Mining Co.* v. *Commissioner*, 149 T.C. No. 3 (July 13, 2017).

Carried Interest

The Act limits, but does not eliminate, the current treatment of carried interest. This is accomplished by increasing the required holding period for long-term capital gain treatment to three years for income realized by a non-corporate taxpayer with respect to an "applicable partnership interest." An "applicable partnership interest" is defined generally to cover partnership interests (not including capital interests) transferred in connection with the performance of certain services by a taxpayer in any "applicable trade or business." An "applicable trade or business" generally includes raising or returning capital and either investing in or developing certain specified assets, including securities, commodities, options, derivatives or real estate held for rent or investment. The limitation is primarily aimed at carried interest held by investment managers, and not at partnership profits interests awarded to management of non-investment services businesses. The new holding period applies with respect to income realized from an applicable partnership interest regardless of whether a Section 83(b) election is made, and also applies to gains generated from the sale of an applicable partnership interest itself. There is no grandfathering for partnership interests received before enactment of the Act.

Amounts denied long-term capital gain treatment pursuant to this provision are treated as short-term capital gain subject to taxation at ordinary rates. This is an important change from earlier versions of the carried interest legislation that would have characterized the amounts as ordinary income. Under the final legislation, it seems clear that the revised treatment of carried interest will not create ECI or unrelated business taxable income ("UBTI") issues, a concern under earlier proposals in this area. Flow-through items other than capital gains, such as "qualified dividend income," are not impacted under the new rules and such items will continue to be taxed at preferential rates. Limited partners holding capital interests in investment funds are not affected and thus retain the one-year holding period requirement for long-term capital gain treatment on allocations from the partnership.

Corporate Tax Reform

The Act permanently lowers the corporate tax rate to 21% and permanently repeals the corporate AMT. AMT credit carryforwards will be refundable up to 50% in 2018, 2019 and 2020 with the balance refundable in 2021. To reflect the lower corporate tax rate, the Act also reduces the dividends received deduction ("DRD") rate, from 70% to 50%, and, with respect to subsidiaries in which the corporate shareholder owns 20% or more (but less than 100%), the DRD is reduced from 80% to 65%.

Immediate 100% Depreciation

The Act permits most taxpayers to expense 100% of the cost of qualified property, which includes certain tangible personal property, acquired by the taxpayer and placed in service after September 27, 2017 and before January 1, 2023 (with an additional year provided for certain qualified property with a longer production period). The expensing percentage phases down in 20% increments from 2023 to 2026.

Taxpayers will also be able to expense "used" property acquired during the relevant period, subject to exclusions for property acquired in certain related party transactions and certain tax-free transactions. Consistent with current accelerated depreciation rules, intangible property and real property are not eligible for immediate expensing. In addition, assets used by businesses that are not subject to the 30% limitation on business interest deductibility discussed below (including assets used in real property businesses that elect out of the interest limitation) generally are not eligible for 100% expensing.

Interest Deductions

Under revised Section 163(j), "business interest expense" can be used fully to offset "business interest income" (defined as interest expense or income, as applicable, that is allocable to a trade or business), but otherwise is disallowed to the extent that it exceeds 30% of the taxpayer's "adjusted taxable income." "Adjusted taxable income" is defined generally as taxable income of the taxpayer but excluding any (i) business interest income or expense, (ii) non-business income or expense, (iii) deductions under Section 199A (deductions for income from "pass-through" businesses discussed above), (iv) deductions attributable to NOL carryforwards, and (v) for tax years beginning before January 1, 2022, deductions for depreciation and amortization (*i.e.*, EBITDA for tax years before 2022, and EBIT thereafter). Disallowed interest expense can be carried forward indefinitely as business interest expense in succeeding taxable years, but will be subject to the ownership change limitations applicable to NOLs under Section 382. In the case of a partnership, the interest deductibility limitation is determined at the partnership level with additional rules for tiering up applicable limitations to the partner level.

Certain taxpayers are exempted from the new interest deductibility limitation, including small businesses averaging annual gross receipts of $25 million or less for the three prior taxable years, as well as real property businesses that elect out of the limitation and certain public utilities. Notably, in contrast to earlier proposals, the Act does not impose an additional interest deduction limitation for U.S. corporations that are part of multinational groups.

We expect that planning opportunities will arise with respect to financings under the new limitation, such as the replacement of debt with preferred stock or convertible debt (with a reduced coupon), or possibly, preferred partnership equity, by highly leveraged companies, to minimize, although not completely eliminate, the tax impact of the limitation.

Changes to NOLs

Under the Act, NOLs generated after December 31, 2017 can be utilized to offset only 80% of a corporation's income in any taxable year, but can be carried forward indefinitely. Subject to very limited exceptions, NOLs will no longer be available for carry back to prior taxable years. Transition relief is provided with respect to NOLs arising in taxable years beginning prior to December 31, 2017, which will

continue to be available for the 2-year carryback and the 20-year carryforward without regard to the 80% taxable income limitation.

Other Changes

The Act limits like-kind exchanges to those involving real property, reduces the circumstances where a taxpayer can deduct entertainment expenses and repeals the deduction for income attributable to domestic production activities. In addition, the Act eliminates or modifies certain credits, including a reduction in the "orphan drug" credit, but, in contrast to earlier versions, does not modify or eliminate any energy credits.

Various changes have been made to tax accounting rules, including a new requirement that a taxpayer recognize most types of income no later than the taxable year in which such income is taken into account as income on an applicable financial statement (generally defined to include financial statements filed with the SEC or equivalent agency and certain other audited financial statements, including those prepared for purposes of reporting to creditors and investors). This change will likely accelerate income recognition for many taxpayers. In particular, the change may accelerate recognition of market discount on debt instruments, which generally is not included in income prior to certain recognition events (such as payment of principal on the debt instrument or sale of the debt instrument at a gain) but may now be included in taxable income on an economic accrual basis if such treatment is required under financial accounting rules.

Other accounting changes include (i) permitting a taxpayer to defer income attributable to certain advance payments in certain circumstances if such income is also deferred for the taxpayer's financial statement purposes and (ii) expanding eligibility requirements for the cash method of accounting for corporations and partnerships with corporate partners, by increasing the ceiling for the average gross receipts test for eligibility from $5 million to $25 million.

The Act also contains significant changes to the taxation of insurance companies.

International Tax Considerations

The Act effects a fundamental change in the United States taxation of multinational operations, by shifting from a world-wide system of international taxation to a modified territorial system through implementation of a partial "participation exemption" regime.

Partial Participation Exemption/Territorial System

Under the new participation exemption system, 100% of the foreign-source portion of dividends paid by a foreign corporation to a 10% or more U.S. corporate shareholder is generally exempt from U.S. taxation.

To qualify for this exemption, the U.S. corporation must have held the stock of the foreign corporation for more than 365 days during the 731-day period beginning 365 days before the ex-dividend date. This exemption does not apply to dividends paid by passive foreign investment companies ("PFICs") that are not also controlled foreign corporations ("CFCs"). The "foreign source portion" of a dividend equals the same proportion of the total dividend as the undistributed foreign earnings of the corporation bears to its total undistributed earnings. The exemption is not available for "hybrid dividends," generally defined as amounts received from a foreign corporation that would otherwise be eligible for the exemption, but for which such foreign corporation received a deduction or other tax benefit from taxes imposed by a foreign country. In addition, no foreign tax credit is available for foreign taxes paid or accrued with respect to any distribution that qualifies for the exemption. Unlike European participation exemption regimes, capital gains on disposition of foreign corporations will not be exempt from U.S. tax.

Deemed Repatriation of Deferred Earnings

In connection with the transition to a partial territorial system, 10% U.S. shareholders of "specified foreign corporations" (including individuals even though they are not eligible for the participation exemption described above) will be subject to a one-time mandatory repatriation tax on the untaxed accumulated earnings and profits ("E&P") of such corporations. A "specified foreign corporation" includes any CFC or other foreign corporation (excluding PFICs) in which a U.S. corporation owns a 10% voting interest. The repatriation tax generally applies to post-1986 accumulated foreign E&P of a specified foreign corporation as of November 2, 2017 or December 31, 2017, whichever is greater, but does not apply to any E&P accumulated prior to the date the corporation became a specified foreign corporation. In calculating the amount of E&P that is subject to recapture, a U.S. shareholder can take into account its share of E&P deficits of any specified foreign corporation in which it holds an interest as of November 2, 2017. The portion of deemed repatriated E&P up to the amount of the foreign corporation's cash and cash equivalents, which includes net accounts receivables, publicly traded securities, and other liquid assets, is subject to tax at a 15.5% effective rate, with the remaining portion taxed at an 8% effective rate. Application of the measurement date rules for determining cash and non-cash positions is complex, especially for taxpayers using a taxable year other than the calendar year. The IRS has already issued some guidance on the application of these rules and we expect to see regulatory guidance issued in this area.

The tax is calculated with respect to the last year of the corporation beginning before 2018, but a U.S. shareholder may elect to pay the deemed repatriation tax liability over a period of eight years. These installment payments are back-loaded, with the majority of the tax paid after the fifth year, and are not subject to an interest charge. Foreign tax credits are partially available to offset the deemed repatriation tax. Certain more favorable rules apply with respect to deferred payment elections made by S corporations. Potential buyers in M&A transactions should diligence exposure of the target company for

the deemed repatriation tax and should consider including appropriate contractual protections, including purchase price adjustments, for these amounts.

The Treasury is authorized to issue regulations to prevent double counting of any deemed income inclusions, as well as rules clarifying the application of the deemed repatriation rules to netting E&P across ownership chains and anti-avoidance rules.

A U.S. shareholder will be subject to an additional recapture tax at an effective rate of 35% with respect to deemed repatriated earnings if it becomes an expatriated entity within the meaning of the inversion rules under Section 7874(a)(2) within the 10-year period following enactment of the Act.

"Global Intangible Low-Taxed Income" and "Foreign Derived Intangible Income"

In an effort to discourage U.S. companies from holding intellectual property in low-tax foreign jurisdictions, the Act imposes a minimum tax on 10% U.S. shareholders of CFCs by requiring each such shareholder to include in income annually (similar to Subpart F income) its portion of the CFC's "global intangible low-tax income" ("GILTI"), which is defined generally as the excess of a U.S. shareholder's pro-rata share of the CFC's net income over 10% of its share of the adjusted tax bases of the CFC's depreciable tangible property used in the production of such income. U.S. corporate shareholders (other than regulated investment companies ("RICs") and REITs) are entitled to a 50% deduction with respect to GILTI in each year, resulting in an effective rate on such income of 10.5%. For taxable years beginning on or after January 1, 2026, the corporate deduction with respect to GILTI will be reduced to 37.5%, increasing the effective tax rate for GILTI to 13.125%.

While the intent of this provision was to discourage U.S. businesses from locating intangible property (such as patents) overseas, as drafted, the definition of GILTI is in no way limited to income from or attributable to intangibles, and this provision thus in fact reaches far more than just income generated by offshore intellectual property holding companies.

As a corollary to the new minimum tax on GILTI and to encourage U.S. companies to hold intellectual property in the United States, U.S. corporations are entitled to a 37.5% deduction for the amount of any "foreign derived intangible income" ("FDII") directly earned by the corporation, resulting in a 13.125% effective rate of tax on such income. This deduction will be reduced to 21.875% for tax years beginning on or after January 1, 2026, increasing the effective tax rate with respect to FDII to 16.406%.

Other Base Erosion Rules

New provisions relating to base erosion include:

- *Hybrid Transaction Rules.* New rules relating to "hybrid entities" and "hybrid transactions" disallow deductions for interest or royalties paid or accrued by a U.S. entity to a related party to the extent such amounts are not treated as income or are deductible in the recipient's resident country. New provisions also authorize the Treasury to issue regulations addressing similar transactions involving branches or other entities that do not meet the statutory definition of a "hybrid entity," potentially impacting common cross-border intercompany transactions.

- *Base Erosion and Anti-Abuse Tax ("BEAT").* The Act imposes a minimum tax on "applicable taxpayers" equal to 10% of their taxable income calculated without regard to payments made to related foreign entities that are deductible or to acquire depreciable or amortizable property (but not payments for costs of good sold). An "applicable taxpayer" generally includes corporations (other than RICs, REITs and S Corporations) that average annual gross receipts of at least $500 million over the prior three-year period and make certain deductible payments to related entities in any taxable year that exceed a specified percentage (generally, 3%) of overall deductions taken by the corporation in such year. Certain banks and securities dealers are subject to the minimum tax once the relevant deductible payments exceed a lower threshold of 2%, and are taxed at an increased rate of 11%. A transition relief rate of tax equal to 5% (6% for banks and securities dealers) is provided for 2018. For tax years beginning after December 31, 2025, the applicable tax rate generally increases to 12.5% (13.5% for banks and securities dealers).

Inversion Transaction Rules

Under the Act, shareholders are denied preferential qualified dividend treatment on dividends received from corporations that become "surrogate foreign corporations" through "60% inversions" after December 22, 2017. The Act also implements provisions restricting the ability of U.S. taxpayers to transfer intangible property overseas tax-free.

Changes to CFC Rules and PFIC Rules

The Act broadens the scope of the CFC rules, by expanding the attribution rules applicable to determining shareholder ownership of a CFC and by revising the definition of a "United States shareholder" to include U.S. taxpayers who own 10% or more of the total value (as opposed to solely the vote) of shares of all classes of stock of such foreign corporation. The change to the attribution rules is retroactive for the last taxable year of the applicable foreign corporation beginning before January 1, 2018 (*i.e.*, 2017 in the case of a calendar year taxpayer). The new definition of "United States shareholder" applies to taxable years beginning after December 31, 2017, providing some measure of transition relief, though this change may

still impact taxpayers who were invested in foreign corporations in 2017 where equity rights with respect to vote and value were separated in order to avoid application of the CFC rules. The Act also eliminates the requirement under prior law that a foreign corporation must constitute a CFC for an uninterrupted 30-day period in any taxable year before its United States shareholders are required to include Subpart F income with respect to the CFC for such year.

The Act also amends the insurance business exception to PFIC classification, providing generally that a foreign corporation will qualify for the exception only if the applicable insurance liabilities of such corporation represent more than 25% of its total assets as reported in its most recent financial statements.

Tax Reform for Individuals

The Act introduces significant changes to the individual income tax regime. Unless otherwise noted, changes with respect to the individual tax regime expire on December 31, 2025.

In addition to the changes discussed below regarding brackets, rates and deductions, the Act permanently changes the index used for inflation adjustments to tax brackets and many other dollar denominated provisions of the tax code to the Chained Consumer Price Index, which, as compared to the Consumer Price Index used under prior law, generally will lead to slightly lower cost of living adjustments each year.

Tax Rates

The Act maintains seven rate brackets, as under prior law, with lower rates and modified thresholds. The highest rate of 37% applies to income over $600,000 for married taxpayers filing jointly. The 20% preferential rate applicable to qualified dividends and long-term capital gains remains unchanged, and the 3.8% net investment income tax continues to apply.

Deductions and Exemptions

The Act makes numerous modifications to the deductions and exemptions available to individual taxpayers.

Personal Exemptions and Credits. The Act essentially doubles the standard deduction, increasing it from $12,700 (in 2017) to $24,000 (in 2018) in the case of joint filers, while repealing the personal exemption provisions. The child tax credit amount is doubled, to $2,000 per qualified child, with the phase-out threshold for the credit increased to $400,000 for joint taxpayers.

State and Local Tax Deductions Significantly Curtailed. Significantly, the Act caps the deduction available for nonbusiness state and local income and property taxes at $10,000. This cap will have the greatest impact on taxpayers resident in high tax jurisdictions, such as California, New Jersey and New

York. Note that while earlier versions of the Act would have limited the deduction to property taxes, the final legislation expands the deduction to include state income taxes as well as property taxes, but still caps the total deduction for both taxes at $10,000. The final legislation provides that state and local income tax payments will be treated as paid on the last day of the year in which the tax is imposed; accordingly, prepayments of 2018 state income taxes in 2017 will be deductible only in 2018, subject to the overall $10,000 deduction cap.[2] State and local taxes remain deductible to the extent incurred in connection with a trade or business.

Mortgage Interest Deduction Changes. The Act further restricts the mortgage interest deduction by eliminating the ability to deduct interest on mortgage amounts in excess of $750,000 (reduced from the prior ceiling of $1 million) and disallowing any deduction for interest paid with respect to home equity loans. Subject to the overall $750,000 limit, interest on mortgage debt will be deductible regardless of whether paid with respect to a primary or secondary residence. Mortgages existing before December 16, 2017 are grandfathered under the previous $1 million threshold, and certain refinancings of grandfathered mortgages will continue to be subject to the $1 million threshold.

Changes to Itemized Deductions. The Act repeals itemized deductions for (i) expenses previously subject to the 2% floor limitation (*i.e.*, expenses incurred for the production or collection of income, including, for example, investment advisory fees and all unreimbursed expenses attributable to the trade or business of being an employee) and (ii) personal casualty losses not incurred in federally declared disaster areas. The Act also repeals the overall limitation on itemized deductions (commonly known as the "Pease" limitation), which reduced the aggregate amount of most itemized deductions for high-income taxpayers.

Limitation on Use of Business Losses. The Act imposes additional limitations on the utilization by individuals and other non-corporate taxpayers of "excess business losses," defined generally as deductions attributable to a trade or business that exceed the income from such business by a threshold amount ($500,000 for joint taxpayers). To the extent that such taxpayers have excess business losses, those losses will be treated as part of the taxpayer's individual NOL and may be carried forward to subsequent years, subject to an annual cap of 80% of taxable income. This limitation on the use of business losses applies in addition to existing passive loss and at risk limitations.

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[2] On December 27, the IRS released guidance that prepayments of 2018 state and local real property taxes will be deductible in 2017 only to the extent that such taxes were "assessed" prior to January 1, 2018. This guidance is intended to prevent taxpayers from deducting prepayments of anticipated 2018 property taxes that were not formally assessed by the relevant jurisdiction prior to January 1, 2018.

Alternative Minimum Tax

The Act maintains the AMT for individual taxpayers, but temporarily increases the exemption amount (to $109,400 for joint taxpayers) and the exemption phase-out thresholds (to $1,000,000 for joint taxpayers).

Estate and Gift Taxes

For transfers occurring after December 31, 2017, the basic exclusion amounts for estate, gift and generation-skipping transfer taxes are doubled to $10 million, as indexed for inflation. Under current law, the inflation adjusted figure for 2018 is $5.6 million. Accordingly, the new exclusion amount for transfers occurring on or after January 1, 2018 is $11.2 million.

FIFO Rule – Not Enacted

Earlier versions of the legislation include a rule that would have required a first-in-first-out accounting for the sale of securities. The Act does not retain this rule and so prior law continues to apply.

Tax-Exempt Organization Considerations

The Act contains a number of new provisions that make the UBTI rules more burdensome on tax exempts generally, including requiring tax-exempt organizations to compute their UBTI on a separate trade or business basis rather than an aggregate basis across all unrelated trades or businesses, as well as treating amounts paid in connection with certain fringe benefits as UBTI.

Importantly, the Act did not adopt prior proposals that would have subjected state and local pension plans (commonly referred to as "super tax-exempts") to tax on their UBTI. Accordingly, the position of super tax-exempt investors that they are exempt from tax on their UBTI is not affected by the Act, and these investors do not need to reconsider their investment structures in private equity funds and hedge funds.

Significant Executive Compensation-Related Amendments

Treatment of Qualified Equity Grants

The Act adds new Section 83(i), which permits eligible employees of private corporations to defer income tax (but not payroll taxes) for up to five years with respect to the exercise of certain compensatory stock options and the settlement of certain restricted stock units ("RSUs"). The deferral privilege is not available to certain corporate insiders, including top officers and 1% owners, and applies only if the awards were made under a broad-based plan that meets certain anti-discrimination requirements (the intended scope of which is not entirely clear).

Proxy Officer Compensation over $1 Million is Nondeductible, even if Performance-Based and Shareholder-Approved; ADR Companies and Issuers of Public Debt Also Affected

Deductions for compensation in excess of $1 million payable to a public company's CEO or three other most highly compensated officers (other than the CFO), as identified in the company's annual proxy statement, were previously permitted under Section 162(m) only with respect to certain performance-based compensation. The Act eliminates this exception for performance-based compensation, broadens the covered employees to include any person who served as the CEO or CFO at any time during the taxable year and expands the companies subject to this provision to include those required to file reports under section 15(d) of the Securities Exchange Act of 1934 (*e.g.*, issuers with a recent registration statement, certain foreign companies whose ADRs trade here, and issuers of public debt). Further, once covered by Section 162(m) after 2016, an individual's compensation from the company in future taxable years, including severance benefits, will remain subject to this deduction limitation. A transition rule provides that the former version of Section 162(m) will continue to apply to compensation paid pursuant to a written binding contract in effect on November 2, 2017 that is not materially modified after such date.

Exempt Organization Compensation: New Excise Tax on Top 5 Executives' Compensation Over $1 Million

The Act introduces a new Section 4960, which expands the principles of Section 162(m) to tax-exempt organizations. Under new Section 4960, compensation (including severance and "parachute" payments) in excess of $1 million payable to any one of the five highest compensated employees of the organization for the applicable taxable year or any past taxable year (after 2016) is subject to a 21% excise tax, payable by the organization. This excise tax also applies to any "excess parachute payments," however, unlike the golden parachutes under Section 280G, the Section 4960 excise tax covers large severance payments irrespective of a change in control transaction.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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