December 28, 2017

U.S. Tax Reform

Infrastructure Provisions

On December 20, Congress voted to pass a comprehensive tax reform bill (the "Act"), and the President signed the Act into law two days later. The Act represents the most significant reform of the U.S. tax code in over 30 years.

The Act is generally consistent with the proposals contained in the bill released by the Senate on November 14 (the "Senate bill"), but it also incorporates certain provisions of the bill released by the House of Representatives on November 2 and amended thereafter (the "House bill"). The Act also removes some provisions that were contained in both earlier draft bills, and includes some new provisions that were contained in neither draft bill.

This memorandum describes some of the important features of the legislation that will affect the taxation of infrastructure investors and investments, and highlights certain areas where the Act diverges from the earlier draft legislation. Whether these provisions will have a positive or negative impact on infrastructure investors or investments—whether greenfield or brownfield—will depend on the facts of each particular investor, investment or project.

Other provisions in the Act affecting corporations and multinationals could also have an impact on infrastructure investors and investments, including, among others, provisions that implement a shift to a territorial tax system and the mandatory deemed repatriation of offshore earnings and profits. These provisions are described in a separate memorandum, which may be obtained by following the instructions at the end of this memorandum.

Most of the provisions described below will be effective for tax years beginning after 2017.

Corporate Tax Rate:

- The maximum corporate tax rate is reduced from 35% to 21%, effective for taxable years beginning after December 31, 2017, and with no sunset provision.

Business-Related Exclusion and Deduction Provisions:

- ***Immediate Expensing of Capital Expenditures*.** Like the Senate bill, the Act allows for temporary 100% expensing for property (other than real estate) acquired or placed in service after September 27, 2017 and before January 1, 2023, with the expensing percentage decreasing by 20% every year thereafter. The Act thus allows corporate taxpayers to claim an immediate deduction at the currently effective 35% corporate tax rate for 100% of the cost of qualified property acquired and placed in service after September 27, 2017 but before this year-end. The Act also includes the House bill's proposal to retain the phase-down of bonus depreciation for property acquired before September 28, 2017 and placed in service after that day.
  - The House bill would have allowed 100% expensing only through 2022, without the subsequent phase-down.
- ***Interest Deductibility Limited*.** The deductibility of net business interest is effectively capped at 30% of EBITDA for five years, and then at 30% of EBIT thereafter. The net interest expense disallowance would be determined at the entity level (e.g., at the partnership level instead of the partner level). Any disallowed amounts may be carried forward indefinitely, subject to a special rule for partnerships. Real estate firms, regulated utilities, and small businesses (with $25 million or less of gross receipts) would be exempt from this limitation. The limitation also does not apply to interest on "floor plan financing indebtedness" (indebtedness used to finance the acquisition of motor vehicles held for sale or lease or secured by such inventory). There is no grandfathering for preexisting debt.
- ***Net Operating Losses*.** Net operating losses arising after December 31, 2017 are deductible only to the extent of 80% of the taxpayer's taxable income, and can be carried forward indefinitely but generally cannot be carried back.
- ***Contributions to Capital.*** Current law provides that the gross income of a corporation generally does not include contributions to the corporation's capital. Narrowing a more broadly worded proposal in the House bill, the Act repeals this tax-free treatment for any contribution in aid of construction or any other contribution as a customer or potential customer, and any contribution by any governmental entity or civic group, in each case for any contributions made after December 22, 2017. However, the Act will not apply to any such contribution made by a governmental entity pursuant to a master development plan that was approved prior to December 22, 2017.
- ***Energy Credit Provisions.*** The House version of the Act would have amended the application of investment and production tax credits that taxpayers may claim in relation to energy production. The Act does not include any of these provisions from the House version.

Bond Provisions:

- ***Repeal of Advance Refunding Bonds*.** Under current law, bonds that are used to pay principal, interest, or redemption price on a prior bond issue (the refunded bond) are categorized as either (i) current (where the refunding bond is issued not more than 90 days before redemption) or (ii) advance (where the refunding bond is issued more than 90 days before redemption). While interest on current refunding bonds is generally not taxable, interest on advance refunding bonds is generally taxable in the case of private activity bonds ("PABs"). Under the Act, interest on all advance refunding bonds issued after 2017 would be includible in gross income.
- ***Repeal of Tax Credit Bonds*.** Tax credit bonds (generally, bonds with respect to which the holder receives a federal tax credit or where, for certain issuances, the issuer had the option of instead issuing taxable bonds and receiving a federal subsidy in the form of a direct payment) have been available to finance specified kinds of projects, subject, in certain cases, to volume caps and allocations. Under the Act, the authority to issue and the rules relating to tax credit

bonds generally are repealed for bonds issued after 2017. Repeal will have no impact on the tax treatment of existing tax credit bonds.

- ***Private Activity Bonds.*** The House version of the Act would have terminated the exclusion from gross income for interest paid on PABs issued after 2017. The Act does not include this provision from the House version.

International Provisions:

- ***Base Erosion Minimum Tax ("BEAT").*** Similar to the Senate bill, the Act includes a base erosion minimum tax, which is essentially a 10% minimum tax (11% for banks and registered securities dealers) calculated on a base equal to the taxpayer's income determined without tax deductions or other tax benefits arising from "base erosion payments." A "base erosion payment" is generally an amount paid or accrued by a taxpayer to a related foreign person that is deductible to the taxpayer, but does not include cost of goods sold (except for payments to companies that invert after November 9, 2017) or qualified derivative payments. This provision applies only to corporations that have average annual gross receipts of at least $500 million (for the three prior tax years) and that have a "base erosion percentage" of at least 3% (2% for banks and registered securities dealers). The base erosion percentage means, for any taxable year, the percentage determined by dividing the corporation's base erosion tax benefits by the total deductions allowed with respect to the corporation. Up to 80% of certain allowable credits may be used to reduce the taxpayer's BEAT liability. The Act does not include the House bill's proposal that would have subjected domestic corporations to a 20% excise tax on payments to a foreign affiliate.
- ***U.S. Tax on Sale of Certain Partnership Interests.*** Overturning a recent case decided by the Tax Court, but consistent with the IRS's position at least since a 1991 revenue ruling, the Act provides that a non-U.S. partner in a partnership recognizes gain or loss treated as "effectively connected" to a U.S. trade or business upon the sale of the partner's partnership interest, to the extent that the partner would be treated as having effectively connected income in a hypothetical sale of all the assets of the partnership. The transferee in such transaction must withhold 10% of the amount realized, unless the transferor certifies that it is not a nonresident alien or foreign corporation. This provision was in the Senate bill but not in the House bill.
- ***No Worldwide Proportionality on Interest Deduction.*** The Act does not include the provision from the House and Senate bills that would have limited the deductible net interest expense of a U.S. corporation to the extent the U.S. corporation's share of its multinational group's global net interest expense exceeds a certain percentage of the U.S. corporation's share of the group's global equity.

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