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Subject Line: Tax Reform Update: Senate and House Tax Differences Emerge

Senate Tax Reform Bill Unveiled

We received details about the Senate's tax reform legislation last night. As we dig through the bill, we want to share a few notes on the issues we're tracking closely, provide a review of where our priorities stand in the bill which the House Ways and Means Committee just passed, then provide some comparison between the new Senate bill and the House bill. We'll be back in touch as we learn more about this bill and as the process unfolds.

Process:

With the Senate bill out, we expect the Senate Finance Committee to go to markup next week. At the same time, we expect the House to bring their bill to the floor next week and work to get to 218 votes necessary for passage. The vote count is not there yet in the House, but it's likely the House Republicans will be able to muster the votes necessary for passage and Senate Republicans will get their bill out of Senate Finance Committee before Thanksgiving.

How the Senate Bill Deals with Issues Directly Affecting the Ecosystem:

- **Carried interest capital gains:** No provision affecting carried interest is included. However, as with the House process, we fully expect to see one before the end of markup. There are conversations about whether to put the 3-year hold period provision from the House bill in or go to a more severe proposal that would tax most carried interest as ordinary income. We are also preparing for amendments on the issue during the committee process.

- **Nonqualified deferred compensation** (taxation of stock options at vesting): A version of the proposal is in there, but from the concerns we have raised, it sounds likely to come out. If it does not, we are prepared to sound the alarms. This was a huge issue that we fought against in the House process once we discovered it, and were pleased to see it come out right before passage of the bill.
- **Capital gains rate:** unchanged.
- **Stock option tax deferral:** Not included in the bill.
- **Qualified Small Business Stock rules:** Preserved.
- **R&D credit offset:** Preserved.
- **Pass-through business tax rate:** Carves out service businesses, including financial services. As with House bill, we believe this means the lower rate will not apply to VC partnerships.
- **Worker classification:** There are several provision impacting worker classification which could have some impact on sharing economy companies. One would create a safe harbor for service providers to not be treated as employees. The other would increase the threshold for certain reporting of payments by marketplace platforms.

House Tax Reform Bill Ways and Means Committee Results
Following additional revisions that were released before the bill was voted out yesterday, below is a summary of the current House language as it relates to our tax reform priorities:

- **Carried Interest Capital Gains:** Carried interest arising from assets held shorter than three years will now be taxed as ordinary income due to a provision included in the modified mark. This means that **capital gains**

rates will still apply to assets held longer than three years. We are pleased that the House Ways and Means Committee has heard our perspective that carried interest based upon holding periods is a much more sensible way to view the issue than blunt changes to the policy that would treat a quick flip of an asset the same as real value created over a number of years. While this is an encouraging sign, please remember: this is still just the beginning of this process; there is a long way and a lot of challenges we will face from now until the end of this process.

- **Qualified Small Business Stock Rules/R&D Credit Offset:** Both QSBS and the ability of early stage startups to offset payroll tax liabilities with R&D credits have been preserved.
- **Stock Options:** We successfully fought against a provision (Section 3801) in the tax reform bill that would have required payment of taxes on non-qualified stock options as they vest, rather than when exercised. This would have been a radical and devastating change to the taxation of equity-based compensation, and hit those working at startups across the entrepreneurial ecosystem with tax bills on unrealized income. Further, because a large percentage of startups fail, Section 3801 will force taxes to be paid on income that will ***never*** be realized. Through the leadership of Majority Leader Kevin McCarthy (R-CA), Rep. Cathy McMorris Rodgers (R-WA) and Rep. Erik Paulsen (R-MN), we sustained a campaign asking the committee to drop Section 3801, which after a long and challenging week they did yesterday afternoon in one of their final changes before passing the bill out of committee.
- **Stock Options Part II:** Once they dropped Section 3801, the House bill became a positive force for stock options and employee ownership because Rep. Paulsen’s Empowering Employees through Stock Ownership Act (EESO) was included as an amendment. This NVCA-supported legislation will allow employees at many private companies to defer paying taxes on

exercised stock options for up to 5 years after vesting or until the company goes public.

- **Capital gains rate:** unchanged.

Bill Comparison
Both bills have broad similarities, including amongst a number of other issues:

- Corporate rate reduction (to 20%).
- Move to a territorial tax system (taxing profits only in the country in which they're earned).
- Create a lower rate on pass-through business income with services carved out.
- Repeal the individual and corporate AMTs.

Both bills lose about $1.5 trillion over the ten-year budget window, adhering to their budget limit. However, the Senate bill, because of reconciliation rules, will not be able to lose money past the budget window, meaning that in the second ten years it will have to be deficit neutral. We don't know yet how that will be accomplished.

This bill differs from the House in a few significant ways on broader issues, including full repeal of the state and local tax deduction, no repeal of the estate tax and delay of the corporate rate reduction until 2019. Here is a quick comparison chart of major issues where the bills differ:

	House Bill	Senate Bill
Corporate Rate	Reduce to 20%	Reduce to 20%, starting 2019
Individual Rates	Four rates: 12/25/35/39.6	Seven rates 10/12/22.5 /25/32.5/35/38.5
Repatriation	Deemed repatriation at 12% for cash/5% for illiquid assets	Deemed repatriation at 10% for cash/5% for illiquid assets
Pass-Through Tax Rate	25% rate on certain business income	30% rate on certain business income
State & Local Tax Deduction	Repeal income tax portion of deduction, $10K cap on property tax deduction	Repeal all
Mortgage Interest	Reduce maximum threshold to $500K	No change to threshold
Estate Tax	Double current exemption to $11M/$22M for 5 years, then repeal	Double current exemption to $11M/$22M; no repeal
R&D Expensing	Require amortization over 5 years	No change

Next week will be a very busy week with bills being considered in both chambers. If you have any questions or just want to get further updates in real time, please contact Justin Field, Vice President of Government Affairs: jfield@nvca.org

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